75-580

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-..................

ALLIS-CHALMERS MANUFACTURING COMPANY,

Petitioner,

—v.—

GULF & WESTERN INDUSTRIES, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

S. HAZARD GILLESPIE
Counsel for Allis-Chalmers Manufacturing Company
1 Chase Manhattan Plaza
New York, New York 10005
Tel. No.: (212) 422-3400

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the

Supreme Court of the United States

October Term, 1975

No. 75-..........

Allis-Chalmers Manufacturing Company,

Petitioner,

—v.—

Gulf & Western Industries, Inc.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Allis-Chalmers Manufacturing Company ("Allis-Chalmers") prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on September 29, 1975.

Opinions Below

The opinion of the United States Court of Appeals for the Seventh Circuit, rendered on September 29, 1975 and as yet unreported, is set forth in Appendix A hereto. The opinion of the United States District Court for the Northern District of Illinois is reported at 372 F.Supp. 570 (N.D. Ill. 1974), and is set forth in Appendix B hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on September 29, 1975. Prior to the entry of judgment, the Court of Appeals *sua sponte* circulated the opinion among all the active judges of that court because, as was candidly acknowledged, the court "adopt[ed] a position on an issue as to which a conflict between circuits exists". 6a n.5.* A majority of the active judges did not request rehearing *en banc,* Chief Judge Fairchild and Judge Cummings voting for rehearing. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

Statute Involved

Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), provides:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

* Citations to "...a" are to the Appendices attached hereto.

Question Presented

Is the purchaser of approximately 29% of the registered equity securities of an issuer, who prior thereto owned no such securities but who within six months after the purchase "voluntarily disposes of" the securities, liable under Section 16(b) of the Securities Exchange Act of 1934, 48 Stat. 896, 15 U.S.C. § 78p(b), to the issuer for all short-term profits realized?

Statement of the Case

Petitioner Allis-Chalmers is a Delaware corporation whose common stock was at all relevant times registered pursuant to the provisions of Section 12 of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78 l.

Respondent Gulf & Western Industries, Inc. ("Gulf & Western"), also a Delaware corporation, is a conglomerate which "had bought and sold controlling interests in a number of corporations" prior to its initial purchase of Allis-Chalmers stock. 2a n.1.

In May 1968 Gulf & Western was interested in acquiring a substantial portion of the outstanding common stock of Allis-Chalmers. Respondent's chairman, Mr. Bludhorn, and president, Mr. Judelson, notified the chairman of Allis-Chalmers, Mr. Stevenson, that respondent was considering acquiring stock in petitioner by means of an exchange, and the next day informed petitioner that Gulf & Western would seek to effect the purchase of 3,000,000 shares of Allis-Chalmers stock by means of an exchange offer.

On July 1, 1968 respondent formally offered to purchase 3,000,000 shares of Allis-Chalmers common stock for a package of cash, subordinated debentures and warrants. These 3,000,000 shares represented approximately 29% of the then outstanding Allis-Chalmers common stock. The exchange offer was fully subscribed to on July 19, 1968, and respondent's shareholders approved the offer on July 29, 1968. Prior to its purchase of these 3,000,000 shares of Allis-Chalmers, Gulf & Western owned none of petitioner's common stock.

Subsequent to the purchase of this 29% block of Allis-Chalmers common stock, respondent entered into an agreement in August 1968 with Oppenheimer Fund, Inc. ("Oppenheimer") whereby respondent would acquire an additional 248,000 shares of Allis-Chalmers common stock held by Oppenheimer. Gulf & Western's purchase of this block of stock occurred on September 30, 1968.

In the period subsequent to its agreement to acquire the second block of Allis-Chalmers common stock, respondent underwent a change of heart as to the attractiveness of owning 3,248,000 shares of Allis-Chalmers stock. The Court of Appeals wrote:

> "On September 13, 1968 Allis-Chalmers chairman Stevenson had on his own initiative met with Bludhorn and Judelson of Gulf & Western and had, according to his recollection at trial, told them that things did not look good for Allis-Chalmers. He refused to quantify the bad news for the Gulf & Western representatives in response to their specific questions, but he clearly disclosed to them his personal negative evaluation of the situation at Allis-Chalmers. Stevenson's notes for this meeting reflected his belief at that time that the Gulf & Western people were 'getting nervous' about their block of stock in Allis-Chalmers. At trial, Stevenson testified that he 'had the feeling right then [at the September 13, 1968 meeting] that they were thinking about disposing of it." 4a n.4.

On the very day of its purchase of the block of Allis-Chalmers stock from Oppenheimer, Gulf & Western commenced negotiations with White Consolidated Industries, Inc. ("White") for the sale to White of the entire block of 3,248,000 Allis-Chalmers shares owned by respondent.

On October 31, 1968 respondent and White reached agreement, and on December 6, 1968 Gulf & Western sold its entire block of 3,248,000 shares of Allis-Chalmers stock to White. Therefore, within a period of less than six months, Gulf & Western had first purchased in two large blocks and then, after apparently "getting nervous" over the prospects of Allis-Chalmers, sold in a single transaction 3,248,000 shares of Allis-Chalmers registered common stock.

The Decision of the District Court

On January 6, 1969 petitioner commenced suit against Gulf & Western, pursuant to Section 27 of the 1934 Act, to recover pursuant to Section 16(b) the short-swing profits that Gulf & Western realized on the two purchases and single sale within less than six months of 3,248,000 shares of Allis-Chalmers common stock. A non-jury trial resulted in a judgment against Gulf & Western in the amount of $1,135,838, the amount the District Court calculated to have been Gulf & Western's profits on the two purchases and single sale of all 3,248,000 shares of Allis-Chalmers stock. The District Court held that respondent was a "beneficial owner" within the meaning of Section 16(b) when it made its initial exchange offer purchase of approximately 29% of petitioner's common stock, and, in accord with rulings of the Courts of Appeals for the Second and Eighth Circuits and decisions of this Court, construed the proviso of Section 16(b) exempting "any transaction where such beneficial owner was not such both at the time of purchase and sale" as not applying to Gulf & Western's initial purchase of more than 10% of the listed equity securities of Allis-Chalmers.

The Decision of the Court of Appeals

Both petitioner and respondent appealed to the Court of Appeals for the Seventh Circuit. Prior to the decision of the Court of Appeals for the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), Gulf & Western principally argued that Section 16(b) did not apply to the purchases and sale involved in this case, relying on the decision of this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

After the decision of the Ninth Circuit, Gulf & Western contended that it was not liable under Section 16(b) for profits realized on the sale of the initial 3,000,000 shares of Allis-Chalmers stock it purchased in July and sold in December 1968. Gulf & Western's position was that because it owned no such stock prior to its exchange offer purchase, it was not a beneficial owner "both at the time of the purchase and sale" and therefore was exempt under the proviso of Section 16(b) from liability for the short-swing profits that it had realized.

The Court of Appeals for the Seventh Circuit relied heavily on the decision of the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 420 U.S. 923 (1975), as well as the language of a Senate bill that was left aside in favor of the present Section 16(b). The Seventh Circuit held that Section 16(b) only applies to "beneficial owners" who, after already owning 10% of the securities of an issuer, thereafter realize profits from the purchase and sale within six months of additional shares. The Court, as noted above, candidly acknowledged "that a contrary view

has been taken in the Second and Eighth Circuits" and that "a conflict between circuits exists." 6a n.5.

Respondent further argued to the Seventh Circuit that its second purchase of stock (from Oppenheimer) on September 30, 1968 was such an integral part of the original exchange offer that the test utilized by this Court in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), must be applied and that respondent should not be liable for the short-swing profits realized from the purchase and sale of that block of stock. The Court of Appeals rejected this contention, holding that the Oppenheimer transaction was neither "an unorthodox transaction" nor devoid of the possibility of speculative abuse.

Petitioner Allis-Chalmers appealed to the Seventh Circuit on the ground that the District Court had improperly calculated the extent of respondent's short-swing profits. The Court of Appeals agreed, holding after detailed analysis of the evidence that respondent had in fact realized profits of $2,465,680.47 from the purchase from Oppenheimer and sale to White of the block of 248,000 shares of Allis-Chalmers stock.

Reasons for Granting a Writ of Certiorari

A writ of certiorari should issue to review the judgment of the Court of Appeals for the Seventh Circuit because that court has rendered a decision which conflicts with decisions of the Courts of Appeals for the Second and Eighth Circuits. The importance of this federal question, concerning the applicability or inapplicability of this remedial statute to far from unusual circumstances, cannot be contested in view of the grant of a writ of certiorari in

Foremost-McKesson, Inc. v. *Provident Securities, Inc.*, 420 U.S. 923 (1975).

Prior to the decision of the Court of Appeals herein, both Allis-Chalmers and Gulf & Western moved for and were granted leave by this Court to file briefs *amici curiae* in support, respectively, of petitioner's petition for certiorari and respondent's opposition thereto in *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, Docket No. 74-742. While the question presented by the instant petition is likely to be decided in *Foremost-McKesson,* that case may involve the resolution of additional questions not here presented. Allis-Chalmers' motion for leave to file an *amicus* brief is included herein as Appendix C.

The narrow question presented here is the construction of the phrase "at the time of" in the exemption for "beneficial owners" provided in Section 16(b). Simply stated, the question is whether a person must first own 10% of the securities of an issuer and then purchase and sell additional shares within six months before short-swing profits must be disgorged. The plain statement of this discrete question completely conceals, however, the profoundly broad practical impact that its resolution encompasses. Does this "prophylactic" statute preclude an issuer from recovering approximately $10,000,000 of short-swing profits realized from the purchase and sale within six months of 29% of the listed securities for the calculated or fortuitous reason that the beneficial owner purchased all such stock in one transaction?

If there is any concern as to what Congress did mean when it limited the coverage of the statute to situations where the beneficial owner is a 10% owner "both at the time of the purchase and sale, or the sale and purchase", Allis-Chalmers suggests that this Court supplied the answer in

Reliance Electric Co. v. *Emerson Electric Co.*, 404 U.S. 418, 423 n.3 (1972). There this Court cites with approval 2 L. Loss, Securities Regulation 1060 (2d ed., 1961) with respect to step sales. Professor Loss' full text covers both step purchases and step sales.

> "A substantial 'out' nevertheless remains for the 10 percent holder: If a person who is not an insider wants to acquire up to, say, 15 percent, he should buy up to just under 10 percent in one transaction (which will be exempted even under the court's construction [in *Stella* v. *Graham-Paige Motors Corp., infra*]) and then buy the remaining 5-plus percent in a separate transaction. Conversely, a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder."

As recognized by the Court of Appeals in the instant case, the Second Circuit consistently has held for 19 years that "at the time of" does not mean "prior to" but "simultaneously with", and that a person is a "beneficial owner" "at the time of" the purchase if more than 10% of a class of registered equity securities are purchased. This construction was first applied in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952), *aff'd on this point*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956). To construe "at the time of" as meaning "prior to" would permit exactly the type of "in and out" profit-taking Section 16(b) was intended to prevent and that has occurred in this case.

The reasons favoring such a construction of Section 16(b) obviously promote the purpose of the 1934 Act. As

stated by the Chief Justice in *Adler* v. *Klawans*, 267 F.2d 840 (2d Cir. 1959):

> "Most recently in Stella v. Graham-Paige Motors Corp., supra, this court gave approval to the District Court's holding that the purchase which makes a person a 10% beneficial owner may be included notwithstanding the express proviso. All three of these cases underscored, either expressly or impliedly, Judge Clark's statement in the Smolowe case that:
>
> > 'The statute is broadly remedial. Cf. Wright v. Securities and Exchange Commission, 2 Cir., 112 F.2d 89. Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty.'" 267 F.2d at 846 (footnote omitted).

The Second Circuit has consistently followed this construction of the phrase "at the time of". *Perine* v. *William Norton & Co.*, 509 F.2d 114, 118 (2d Cir. 1974); *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970).

The holding of *Stella* was adopted by the Eighth Circuit in *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972). The Court of Appeals there observed that:

> "[a]ny other view [of the meaning of the phrase 'at the time of'] has the weakness of impracticability of appli-

"cation of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." 434 F.2d at 924.

Despite this Court's observation that "the legislative history [of Section 16(b)] affords no explanation of the purpose of the proviso", *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972), the Ninth Circuit in *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted,* 420 U.S. 923 (1975), purported to find legislative history supporting a construction of "at the time of" as meaning "prior to". As set forth fully in Allis-Chalmers' brief as *amicus curiae* in support of Foremost-McKesson, Inc.'s petition for a writ of certiorari, reproduced in Appendix C hereto, the Ninth Circuit reached this conclusion on the basis of language contained in a Senate bill which was never enacted. As shown in Allis-Chalmers' *amicus* brief, the legislative history of the House bill, which was the lineal predecessor of Section 16(b), supports petitioner's position. The House bill was introduced almost a month *after* the hearings on a Senate bill upon which the Ninth Circuit erroneously relied in reaching its construction of the proviso of Section 16(b). See 87a-92a.

In the present case, the Seventh Circuit stated that it agreed with much of the Ninth Circuit's analysis of the legislative history, thereby perpetuating that Court's erroneous construction of Section 16(b). 15a-19a. Allis-Chalmers submits that, to the extent relevant legislative

history exists, it supports the position of the Second and Eighth Circuits that Congress intended to bar an insider from retaining the type of short-swing profits realized here by Gulf & Western.

As is obvious from the facts of this case, Gulf & Western's reliance on *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), is entirely misplaced. That the decision therein, involving an involuntary, forced disposition of the shares as part of a corporate reorganization, is inapposite requires no extended comment. Even the Court of Appeals for the Seventh Circuit, in the present case pointed out that Gulf & Western

> "voluntarily disposed of the [Allis-Chalmers] shares within six months, *after* obtaining an indication from Allis-Chalmers' chairman that the future of that company did not look any too bright. The possibility clearly existed, therefore, that Gulf & Western's early disposition of its Allis-Chalmers shares was an attempt to avoid the effect of the predicted weakening of Allis-Chalmers' common stock, a prediction gained as an insider of that company." 24a (emphasis in original).

This Court stated in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972):

> "To be sure, where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders". (Footnote omitted.)

Clearly the situation in which a corporation makes an initial purchase of almost 29% of the common stock of

another and sells the entire block within six months at a handsome profit constitutes exactly the opportunity for short-term speculation Congress intended to prevent by enacting Section 16(b). The applicability of Section 16(b) would be severely if not fatally curtailed with respect to a variety of situations in which Congress attempted by means of a flat rule to prevent the *possibility* of "the unfair use of information". The construction of Section 16(b) adopted by the Courts of Appeals for the Seventh and Ninth Circuits not only does plain violence to the Congressional purpose underlying Section 16(b) but cannot logically be found in the statute or gleaned from the legislative history. The conflict among the Courts of Appeals over the construction of a statute prescribing important national policy must, and can only be, resolved by this Court.

CONCLUSION

For the reasons set forth above, petitioner Allis-Chalmers Manufacturing Company prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit, or, in the alternative, that this Court withhold action on this petition pending the decision of this Court in *Foremost-McKesson, Inc.* v. *Provident Securities Co.,* Docket No. 74-742, and thereafter dispose of this petition in accordance with any decision therein which may control the issue presented by this petition.

Dated: October 16, 1975

Respectfully submitted,

S. Hazard Gillespie
Counsel for Allis-Chalmers Manufacturing Company
1 Chase Manhattan Plaza
New York, New York 10005
Tel. No.: (212) 422-3400

APPENDICES

APPENDIX A

Opinion of the United States Court of Appeals for the Seventh Circuit

In the

United States Court of Appeals

For the Seventh Circuit

Nos. 74-1266 and 74-1267

ALLIS-CHALMERS MANUFACTURING COMPANY,
a Delaware Corporation,

Plaintiff-Appellant,

v.

GULF & WESTERN INDUSTRIES, INC.,
a Delaware Corporation,

Defendant-Appellee.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division—
No. 70 C 513
JAMES B. PARSONS, *Judge.*

ARGUED JANUARY 14, 1975 — DECIDED SEPTEMBER 29, 1975

Before CLARK, *Associate Justice (Retired)*,* SWYGERT and PELL, *Circuit Judges.*

SWYGERT, *Circuit Judge.* This appeal presents several issues concerning the proper construction of section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b). The section, which seeks to prevent misuse of internal corporate information, requires certain statutorily defined corporate insiders to remit to their corporation any profits realized as a result of any transaction consisting of a purchase and subsequent sale, or sale and

* The Honorable Tom C. Clark, Associate Justice (Retired) of the Supreme Court of the United States, is sitting by designation.

repurchase, which is completed within six months. Included among the insiders covered by the section are owners of more than ten percent of any class of equity security registered under the provisions of section 12 of the Act, 15 U.S.C. § 78(*l*). In this case we must determine whether the section applies to an initial purchase of more than ten percent of a covered security by one who was an outsider until that purchase was consummated. In addition we must decide whether the facts in this case so completely preclude the possibility of misuse of inside information that application of the section to this type of transaction could serve no purpose. Finally, questions exist as to the proper method of determining the profits realized where a violation is found.

In May of 1968, Gulf & Western Industries, Inc.[1] began actively to contemplate the acquisition of a substantial interest in Allis-Chalmers Manufacturing Company.[2] In this connection, Charles G. Bludhorn, chairman of the board of Gulf & Western, and David N. Judelson, its president, contacted Robert S. Stevenson, the chairman of the board at Allis-Chalmers. First contact was made on May 6, 1968. Bludhorn and Judelson indicated that Gulf & Western was considering an exchange offer and that they would keep Stevenson advised as these plans developed. On the following day Stevenson was informed that an exchange offer would immediately be announced by Gulf & Western, pursuant to which Gulf & Western would seek to acquire 3,000,000 shares of Allis-Chalmers common stock in return for a per share consideration of $11.50 cash plus $12.50 principal amount of a Gulf & Western six percent subordinated debenture due in 1988 plus 9/10 of a ten-year registered Gulf & Western warrant to purchase Gulf & Western common stock at fifty-five dollars per share.

The offer was formally made through a prospectus dated July 1, 1968. By its terms, Gulf & Western agreed

[1] Gulf & Western is a Delaware corporation engaged in diversified pursuits including manufacturing, distribution, mining, agricultural, and other operations. The record indicates that prior to the transaction here involved, Gulf had bought and sold controlling interests in a number of corporations.

[2] Allis-Chalmers is a Delaware corporation whose common stock is, and was at all relevant times, registered on the New York Stock Exchange pursuant to 15 U.S.C. § 78(l).

to accept Allis-Chalmers shares tendered prior to July 19, 1968 on a pro-rata basis up to a total of 3,000,000 shares accepted. If less than 3,000,000 shares were tendered by July 19th, then Gulf & Western further agreed to accept additional shares thereafter on a "first-come, first-served basis," up to the 3,000,000 limit. The offer was subject to the approval of the Gulf & Western stockholders at a meeting to be held on July 29, 1968, and was to expire in any event on July 30, 1968 unless extended prior thereto by Gulf & Western. All tenders of Allis-Chalmers stock were to be irrevocable by the tendering party. The offer was fully subscribed by July 19, 1968 so that no shares tendered thereafter could be accepted under the terms of the offer, no extension having been made by Gulf & Western. The shareholders of Gulf & Western approved the offer on July 29, 1968.

After this initial acquisition, on August 28, 1968, Gulf & Western entered into an agreement with Oppenheimer Fund, Inc. whereby they would acquire 248,000 additional shares of Allis-Chalmers stock owned by Oppenheimer in return for 496,000 warrants for the purchase of Gulf & Western common stock. The closing date for the agreed exchange was to be September 30, 1968. The warrants were not to be registered initially, but according to the agreement Gulf & Western was to file a registration statement for these warrants and for the shares of Gulf & Western stock to be issued thereunder on or before April 30, 1969. In addition, Gulf & Western agreed that if the registration statement became effective later than December 31, 1968, it would guarantee an average per warrant price of $13.50 for any warrants sold by Oppenheimer within ninety days after actual registration. This was to be accomplished either by a payment from Gulf & Western of the difference between the average sale price and $13.50, or by Gulf & Western supplying a purchaser willing to take the warrants at the guarantee price or better.[3] This exchange was carried out, the closing being held on September 30, 1968. The registration statement

[3] The agreement provided that if the guarantee were invoked Gulf & Western would have three business days during which to find a purchaser willing to pay a higher price than the price at which Oppenheimer intended to sell the warrants. If no such purchaser was found, then Oppenheimer would be free to sell and to seek a cash payment under the guarantee for all shares sold during the ninety-day period.

did not become effective until after December 31, 1968, and after an agreed extension of the guarantee period, Oppenheimer in fact sold 487,500 warrants subject to the guarantee and obtained a payment thereunder from Gulf & Western in the amount of $2,154,437.50 on June 5, 1969.

One month after the Oppenheimer acquisition, on October 31, 1968, Gulf & Western reached an agreement with White Consolidated Industries, Inc. whereby White would purchase Gulf & Western's entire holding in Allis-Chalmers, which at this point consisted of 3,248,000 shares of Allis-Chalmers common stock. This agreement was the result of negotiations between Gulf & Western and White which had commenced with a meeting between Mr. Bludhorn and White representatives on September 30, 1968, the very day that the Oppenheimer exchange was closed.[4] The White acquisition was consummated on December 6, 1968. Gulf & Western received in return for its Allis-Chalmers stock 250,000 unregistered shares of White common stock plus $20,000,000 in cash plus a 180-day promissory note at 8.5 percent interest in the face amount of $93,680,000. The promissory note was given in lieu of cash pursuant to a payment option in the October 31, 1968 agreement with Gulf & Western and was in fact redeemed with interest by White on March 20, 1969.

On January 6, 1969 this action was commenced by Allis-Chalmers in the Eastern District of Wisconsin. On motion of Gulf & Western the cause was transferred to the Northern District of Illinois. 309 F. Supp. 75 (E.D. Wis. 1970). A trial was conducted without a jury, and Gulf & Western was held liable to Allis-Chalmers for all profits realized as a result of the purchase and sale of all 3,248,000 shares of Allis-Chalmers stock. Profits were found by the district judge in the amount of $1,135,838.00 and judgment was entered against Gulf & Western and in

[4] On September 13, 1968 Allis-Chalmers chairman Stevenson had on his own initative met with Bludhorn and Judelson of Gulf & Western and had, according to his recollection at trial, told them that things did not look good for Allis-Chalmers. He refused to quantify the bad news for the Gulf & Western representatives in response to their specific questions, but he clearly disclosed to them his personal negative evaluation of the situation at Allis-Chalmers. Stevenson's notes for this meeting reflected his belief at that time that the Gulf & Western people were "getting nervous" about their block of stock in Allis-Chalmers. At trial, Stevenson testified that he "had the feeling right then [at the September 13, 1968 meeting] that they were thinking about disposing of it."

favor of Allis-Chalmers in this amount. 372 F.Supp 570 (N.D. Ill. 1974). Both parties appeal from this judgment.

I

The first question we must resolve is whether the transaction consisting of initial acquisition of 3,000,000 shares of Allis-Chalmers common stock and its subsequent sale by Gulf & Western falls within that class of transactions subject to section 16(b) of the Securities Exchange Act. That section provides in relevant part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. . . . This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

The term "beneficial owner" is defined in section 16(a) and includes "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security . . . registered pursuant to [15 U.S.C. § 78(*l*)]."

There is nothing in the record to indicate that prior to the July 1968 exchange offer Gulf & Western had any legally significant relationship with Allis-Chalmers. Only when the July acquisition was completed did Gulf & Western become a "beneficial owner" within the meaning of section 16(b). Thus, there is no possibility under the facts of this case that Gulf & Western could have made "unfair use of information . . . obtained . . . by reason of [its]

relationship to [Allis-Chalmers]" until after the initial acquisition. The precise question is therefore whether section 16(b) applies to a purchase/sale short-swing transaction where the decision to initiate the transaction (i.e., purchase the stock) could not have been premised on use of information obtained through a section 16(a) insider relationship with the issuing company. We are mindful, however, that the intent and purpose of legislation "must [be] glean[ed] from the statute as a whole rather than from isolated parts." *Adler* v. *Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). We therefore have examined the language of section 16(b) in its totality. This examination, and a consideration of the legislative development of section 16(b) convinces us that the statute was never intended to reach such a transaction.

A

We realize that a contrary view has been taken in the Second and Eighth Circuits. On the other hand, the Ninth Circuit has recently decided this issue consistent with our interpretation, based on a thorough review of the legislative history of section 16(b).[5] A discussion of these conflicting precedents is pertinent.

[5] Since Part I of this opinion adopts a position on an issue as to which a conflict between circuits exists, this opinion has been circulated to all the active judges of the court. A majority of the active judges have not requested a rehearing *en banc*, and no rehearing will be held, pursuant to Internal Rule 2.

Judge Philip W. Tone has disqualified himself from any consideration of this case and has asked that this fact be noted.

Chief Judge Thomas E. Fairchild and Judge Walter J. Cummings have asked that their votes in favor of rehearing be noted.

Judge John Paul Stevens has asked that his separate views be noted:

STEVENS, Circuit Judge. Although I voted against a rehearing en banc because I agree with Judge Swygert's basic conclusion that the fact of critical importance is the controlling person's presumed access to inside information at the time of his decision either to buy or to sell, I do not agree with his reading of the clause making § 16(b) inapplicable to "any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved. . . ." I think the word "both" refers to both times, that is, the time of purchase and the time of sale, rather than to both a purchase-sale and a sale-purchase. The word "or" in the clause, as well as the Supreme Court's holding in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, require this reading. This reading is not contrary to Judge Swygert's holding because Gulf & Western was a controlling person both at the time of its purchase of the 348,000 shares and also at the time of its sale of those shares.

In *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952), *recognized as law of the case*, 132 F.Supp. 100 (S.D.N.Y. 1955), *aff'd in part, remanded in part on other grounds*, 232 F.2d 299 (2d Cir. 1956), *cert. denied*, 352 U.S. 831 (1956), District Judge Samuel H. Kaufman was confronted with the following facts. In 1945 the Kaiser-Frazer Corporation was organized. Its capital structure consisted of 500,000 shares of common stock, half of which were owned by Graham-Paige Motors Corporation. In that same year Kaiser-Frazer issued 1,700,000 new shares of common stock, bringing the proportional Graham-Paige interest down from fifty percent to 11.34 percent. On January 23, 1946 Kaizer-Frazer issued 1,800,000 additional shares. This cut the Graham-Paige interest down to 6.25 percent, or well below the level constituting section 16 (b) beneficial ownership. About a year later, on February 10, 1947, Graham-Paige purchased 750,000 additional shares of Kaiser-Frazer stock. With the completion of this acquisition, Graham-Paige was once again a beneficial owner, with holdings constituting twenty-one percent of Kaizer-Frazer stock. One day less than six months later, on August 9, 1947 Graham-Paige sold 155,000 shares of Kaiser-Frazer common stock. A stockholder of Kaiser-Frazer brought suit on behalf of that corporation to recover any profit from that sale.

Judge Kaufman held that the purchase on February 10, 1947 by which defendant Graham-Paige resumed its beneficial owner status could be matched with the sale of August 9, 1947 to constitute a section 16 (b) transaction even though Graham-Paige was not a beneficial owner immediately prior to the February purchase. He based this determination on an "ambiguity" in the exemption language contained in section 16 (b). That language reads:

> This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved. . . .

Judge Kaufman saw two reasonable interpretations of the words "at the time of" as used in this passage. He noted that these words could mean "prior to" as defendant contended, or "simultaneously with" as urged by the

plaintiff and the Securities and Exchange Commission, as *amicus*. Recognizing that the Congressional purpose behind section 16 (b) was "to protect the outside stockholders against at least short-swing speculation by insiders with advance information" 104 F. Supp. at 959 [citations omitted], he adopted the "simultaneously with" construction and held Graham-Paige liable. Judge Kaufman based his holding in part on the fear that the "prior to" interpretation would allow "a person to purchase a large block of stock, sell it out until his ownership was reduced to less than ten percent, and then repeat the process, ad infinitum." *Id.* at 959. This construction was accepted as the law of the case by District Judge Dimock in a subsequent district court opinion and was affirmed without analysis by the Second Circuit, Judge Hinks dissenting. Judge Hinks reasoned in part:

> [T]he basic rationale of the Act was such that only completed swing transactions gave rise to the presumption of unethical use of advance information: if one purchased stock on one day, became a director on the next, and sold some of his stock on the next, any resulting profit was not recoverable by the corporation apparently because a sale alone was thought to be insufficient basis for a drastic presumption that it had been made in violation of a fiduciary duty. In principle, the same rationale is equally applicable to beneficial owners who do not become such until a given purchase is consummated. Under that rationale, the presumption will arise only when both the purchase and the sale were made by one who at the time was a fiduciary.
>
> 232 F.2d at 305.

Judge Kaufman's construction continues to be authoritative in the Second Circuit.[6]

In the Eighth Circuit, the *Stella v. Graham-Paige Motors Corporation* construction of section 16 (b) was expressly adopted in *Emerson Electric Co. v. Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd*, 404 U.S. 418 (1972). The Supreme Court's affirmance in *Emerson*, however,

[6] *Newmark v. RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir. 1970); *Perine v. William Norton & Co., Inc.*, 509 F.2d 114, 118 (2d Cir. 1974).

never reached this question. 404 U.S. at 421.[7] Looking then to the Eighth Circuit opinion, we find the following factual situation. Emerson Electric became interested in acquiring Dodge of Mishawaka, Indiana, a small manufacturer of electric transmission equipment. Emerson initiated merger negotiations. Dodge rejected the idea of merger, and Emerson then made a tender offer for Dodge common stock. Through this offer, Emerson acquired 13.2 percent of Dodge common stock. Dodge, however, was at the same time negotiating a defensive merger with Reliance Electric, a competitor of Emerson. A proxy fight ensued, and Reliance was the victor, the proposed defensive merger being approved by the Dodge shareholders. Shortly thereafter Emerson decided to liquidate its position in Dodge prior to final director approval of the Dodge/Reliance merger. Recognizing the possible section 16 (b) problem in doing so within six months of the original acquisition, Emerson liquidated in two steps, the first sale bringing its Dodge holdings down to 9.9 percent and the second sale disposing of this balance. Both steps of the liquidation were carried out within six months of the original acquisition.

In determining that Emerson was liable for the profits gained in the first step of the two-step sale of Dodge stock, the Eighth Circuit reasoned that the phrase "at the time of" was ambiguous. The court saw three possible meanings attributable to the phrase in the context of section 16 (b): (1) "immediately before," (2) "simultaneously with," or (3) "immediately after."[8] Next, the court noted that in its opinion it was "doubtful that Congress intended it to have one of those meanings in every situation." 434 F.2d at 923. This suggestion was necessary to the court's

[7] The Supreme Court concentrated its analysis exclusively on the "second sale" by which Emerson disposed of its remaining 9.96% interest in Dodge stock. Its decision was founded on the fact that this sale was made when Emerson was no longer a "beneficial owner" within the terms of the statute, and on the fact that SEC Rule 16a-10, 17 C.F.R. §240.16a-10, exempts from 16(b) any transaction involving a sale made during a month in which the stockholder never owned more than a 10% interest. *But see* 404 U.S. at 440-41 (Douglas, J. dissenting).

[8] We are unable to see any practical difference between "simultaneously with" and "immediately after" as used in *Emerson*, unless "simultaneously with" merely means *either before or after* depending on which construction best suits the purpose of the statute as perceived by the judge applying it. *See* Note, *Stockholder Acquiring 10%*

decision to follow the *Stella* rationale because the Eighth Circuit recognized the logical anomaly of the *Stella* rule, namely, that if "at the time of" is uniformly construed to mean "simultaneously with" the execution of the purchase or sale, then in every buy/sell transaction in which the sale reduces the defendant's holdings to *below* ten percent of the issuing corporation, as was the case in the first sale in the *Emerson* liquidation, that sale would call into effect the exemption provision. That is, "at the time of" such a sale (the instant it became effective) the defendant would no longer be a beneficial owner. Faced with this legal puzzle, the *Emerson* court was forced to define "simultaneously with" to mean *both* "before" *and* "after" depending on which end of the short-swing transaction is being analyzed: "a 10 percent stockholder need only be such simultaneously with each transaction; that is, just after a purchase or just before a sale." 434 F.2d at 923 (footnote omitted).[9]

In adopting this construction the court recognized that "the problem of interpretation is difficult and not free of all doubt." Nonetheless, the court was persuaded that the Congressional intent to stop the possible use of inside information by directors, officers and beneficial owners in connection with short-swing transactions demanded this construction to avoid "impracticability of application." Illustrative of the problems perceived by the *Emerson*

[8] (Continued)

Ownership on Purchase Held Liable for Profits Under Section 16(b) *of the Securities Exchange Act*, 57 Colum. L. Rev. 287, 289 (1957) (cited by the Eighth Circuit in *Emerson*). In this light, it is interesting to note the district court's formulation of the issue, and its answer, in the *Emerson* litigation:

> [W]e are convinced that "at the time of purchase" includes the time "simultaneously with" the purchase, so that a shareholder becomes subject to the provisions of Section 16(b) immediately upon (that is, at the very moment of) his acquisition of more than 10 per cent of the corporation's stock." *Emerson Electric Co.* v. *Reliance Electric Co.*, 306 F. Supp. 588, 589 (E.D.Mo. 1969) (original emphasis).

The use of the verb "includes" would imply that the district judge perceived the phrase "at the time of" to cover both "prior to" and "simultaneously with," and it is clear from the result reached that his conception of "simultaneously with" is virtually indistinguishable from "immediately after."

[9] The quoted words were used by the Eighth Circuit to describe the holding of the Second Circuit in *Stella*. In deciding the case before it, the Eighth Circuit avoided restating this inconsistency by focusing narrowly on the facts presented, but it is clear that the court did adopt this dual-meaning construction of "at the time of."

court was the possibility that one might purchase a block of stock as large as fifty-one percent and then sell within six months with section 16 (b) impunity even though *after* the purchase of this block such an investor would be in a position to obtain inside information and exercise influence over corporate transactions.

The Ninth Circuit, in the recent case of *Provident Securities Co.* v. *Foremost-McKesson, Inc.*, 506 F.2d 601 (9th Cir. 1974), *cert. granted*, 42 U.S.L.W. 5446 (U.S. Feb. 18, 1975), rejected the application of section 16 (b) to an initial ten percent acquisition. In doing so, the court expressly recognized the contrary decisions of the Second and Eighth Circuits, but declined to follow them. This decision was based in part on an analysis of dicta contained in the Supreme Court's opinions in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972) and *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973), and in part on a review of the legislative history of section 16 (b).

The court in *Provident* began its discussion of the initial purchase issue by noting that in *Reliance* the Supreme Court placed great emphasis on the requirement that a section 16 (b) beneficial owner/defendant be such a beneficial owner "both at the time of purchase and sale. . . ." 506 F.2d at 608. Turning to the subsequent *Kern* opinion, the court quoted the initial formulation of issues by the Supreme Court in that case:

> Unquestionably, one or more statutory purchases occur when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders. But is it a § 16 (b) "sale" when the target of the tender offer defends itself by merging into a third company and the tender offeror then exchanges his stock for the stock of the surviving company and also grants an option to purchase the latter stock that is not exercisable within the statutory six-month period?
>
> 411 U.S. at 584.

Recognizing the ambiguity in the first sentence of this passage, the *Provident* court opined that the reference to "one or more statutory purchases" may have indicated that statutory purchases occur only *after* the purchaser has

acquired an initial ten percent.[10] The court pointed out that this interpretation would be consistent with the following additional language in *Kern*:

> If its takeover efforts failed, it is argued, Occidental knew it could sell its stock to the target company's merger partner at a substantial profit. Calculations of this sort, however, *whether speculative or not* and whether fair or unfair to other stockholders or to Old Kern, *do not represent the kind of speculative abuse at which the statute is aimed, for they could not have been based on inside information obtained from substantial stockholdings that did not yet exist.* Accepting both that Occidental made this very prediction and that it would recurringly be an accurate forecast in tender-offer situations, we nevertheless fail to perceive how the fruition of such anticipated events would require, or in any way depend upon, the receipt and use of inside information. If there are evils to be redressed by way of deterring those who would make tender offers, § 16 (b) does not appear to us to have been designed for this task. 411 U.S. at 597 (footnote omitted).[11]

Turning to the legislative history of section 16 (b), the *Provident* court noted that early drafts of the section focused on the intention of a corporate insider in making a purchase of his company's stock, not to change his investment relationship to the corporation, but to capitalize on inside information by entering into a short-swing purchase/sale transaction in an upward market. According to the court in *Provident*, part of the design of this scheme would be for the insider to come out of the transaction with "exactly the same interest in the corporation as he owned before he began his speculative venture." 506 F.2d at 609. These drafts, however, did not cover the converse situation: the sale by an insider of his corporation's stock

[10] The original offer in *Kern* was made on a first-come, first-served basis, so in all probability a number of the separate purchase transactions involved in the original offer were consummated *after* the particular purchase which put Occidental over the 10% ownership level.

[11] Two additional factors undercut any attempt to characterize *Kern* as an approval of the *Stella* rationale, as suggested by defendants in this case: first, *Stella* was never cited in the *Kern* opinion, and second, the Court specifically noted elsewhere in the opinion that the decision to extend the original offer to encompass an additional 500,000 shares was made *after* the acquisition of a 10% interest by Occidental. 411 U.S. at 584-85, n. 7.

in a downward market with the intent of replacing it at a lower price over a short term. To remedy this omission, the operative language was modified in part. Where the early drafts had read:

> [A]ny profit made by such person on any *transaction* in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer. 506 F.2d at 609 (emphasis added),

the later drafts read:

> [A]ny profit realized by [such person] from any *purchase and sale, or any sale and purchase,* of any equity security of such issues . . . within any period of less than six months . . . shall inure to and be recoverable by the issuer. 506 F.2d at 610 (emphasis added).

The *Provident* court saw no indication that this change was intended to alter the original intent of focusing on insider status at the time of entering into the short-swing transaction. Moreover, it reasoned that the presumptions created by the statute necessarily assume this premise:

> The drafters recognized, however, the difficulty of proving that the insider actually intended a short-swing transaction when he made his original decision . . . . In order to ameliorate this difficulty of proving intention or expectation, the section created a statutory presumption that a person with access to inside information who purchases and sells, or sells and repurchases, within a six-month period does so with the intent to speculate rather than to invest. That the drafters intended for the presumption to be conclusive is clear . . . .
>
> Since the presumption of intention or expectation is conclusive, it is necessary that it be narrowly construed so as to apply only to the class of persons who can reasonably be expected to have access to inside information. The hearings demonstrated that Congress intended that the class not be defined too broadly . . . .
>
> As the Committee testimony indicates, the section also creates a presumption that officers, directors and 10-percent shareholders fall within the class of persons who may reasonably be expected to have access to inside information (statutory insiders). It does not

appear, however, that this presumption (as distinguished from the presumption of intent to speculate) is always conclusive, since the Supreme Court has held that at least in some situations it may be rebutted. *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S.Ct. 1736, 36 L.Ed.2d 503 (1973).

Nevertheless, the legislative history demonstrates that the class was not intended to include outsiders....

Since a person who decides to purchase enough stock to increase his holdings to 10 percent of a corporation's outstanding shares is an outsider at the time he makes his investment decision, he does not fall within the class of persons to which the conclusive presumption was intended to apply. He may have made that decision on the basis of inside information, but such inside information could not have been acquired, in the language of the statute, "by reason of his relationship to the issuer," or in the language of the Supreme Court, "from substantial stockholdings that did not yet exist." *Kern County Land Co.*, 411 U.S. at 597. We hold that the initial purchase by which a person increases his holdings to 10 percent of a corporation's outstanding stock is not a section 16 (b) transaction and that the conclusive presumption imputing an intent to speculate does not apply to such a person who sells within six months. The statutory language "at the time of," in order to be consistent with the rationale of the statutory presumption, must be construed to mean prior to the time when the decision to purchase is made. 506 F.2d at 610-14 (footnote omitted).

Finally, the court in *Provident* felt compelled to address another context in which section 16 (b) might be applied. In doing so, it created its own modified version of the Eighth Circuit's dual-meaning theory:

This construction, however, should not be applied to a transaction that is not an initial purchase but in reality is a repurchase or a closing transaction. It would be inconsistent with the rationale of the presumption and with the legislative history to allow a principal shareholder to sell his holdings below the 10 percent level and then repurchase at a profit within six months. Where a shareholder was within a class of persons who had access to inside information by

reason of their relationship to the issuer prior to making his initial decision to speculate, the conclusive presumption should be applied if simultaneously with the conclusion of the closing transaction he is the owner of 10 percent of the issuer's stock. Although this conclusion mandates that the language "at the time of" means *prior to* in the case of an initial transaction and *simultaneously with* in the case of a closing transaction, we do not believe that this "inconsistency" is inconsistent with the rationale of the section. In order for the statutory presumption of intention or expectation to deter speculation rather than to impose an arbitrary hardship on a good faith investor, it must apply only to shareholders who, at the time they make the decision to purchase or to sell, are within the class of persons who can reasonably be expected to have access to inside information by reason of their relationship to the corporation. This conclusion does not provide a consistent construction of the language "at the time of" for both the initial and the closing transactions, but it is consistent with the rationale of section 16 (b)—a consistency that we believe is much more important than the consistency of terms. 506 F.2d at 614-15 (footnote omitted).

B

While we agree with much of the analysis in the Ninth Circuit decision in *Provident*, we are convinced that a fundamental conceptual error, initiated in the *Stella* decision, has survived even the careful analysis in *Provident*. It is our view that the legislative history of section 16 (b) provides ample support for a construction of that section which obviates any necessity, under any circumstances, to attribute to Congress an intent to utilize a chameleonic definition of the simple phrase "at the time of." We adopt this simplified construction with full recognition that section 16 (b) is a remedial statute which has a wholesome purpose. *Emerson Electric, supra*, 434 F.2d at 923 and n. 14. This, of course, begs the real question: what *is* that purpose? Our review of the history of the statute convinces us that in enacting section 16 (b) Congress had in mind a specific type of two-part transaction consisting either of a purchase and subsequent sale, or a sale and subsequent repurchase, and did not intend section 16 (b)

to apply to every *separate* purchase or sale as to which some use of inside information is a theoretical possibility.

As Judge Wallace pointed out in *Provident*, the early draft of section 16 (b) did not address the problem of a sale/purchase insider scheme. This apparently was an oversight. The language of the early draft is instructive, however, since it makes clear that Congress originally treated the purchase/sale procedure as a conceptual unit:

> (b) It shall be unlawful for any [beneficial owner]
>
> (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person *on any transaction in such a registered security extending over a period of less than six months* shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such *transaction* of holding the security purchased for a period exceeding six months. *Hearings on S. Res. 56 and S. Res. 97, Before the Senate Comm. on Banking & Currency*, 73d Cong., 1st Sess., Pt. 15, at 6430 (1934) (emphasis added).

As used in the initial draft, the term "transaction" obviously included both purchase and sale. The critical point for measuring insider status (*i.e.*, beneficial ownership) was *prior* to the opening purchase of stock. Thus the section focused on purchases made "with the intention or expectation of selling" within six months, but obviated the need for proof of such intention or expectation "in entering into such transaction." Given the fact that the section was aimed at preventing speculation based on abuse of inside information, the section must have contemplated a *pre-existing* beneficial interest: unless the opening purchase was motivated by an insider's anticipation of an upward market, the full purchase/sale transaction could hardly be characterized as "speculative" from the standpoint of insider abuse. *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. at 597.

When the section was revised to include a sale/repurchase transaction, the term "transaction" was replaced at one point with words describing the two types of insider schemes to be covered by section 16 (b):

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him *from any purchase and sale, or any sale and purchase*, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months . . . .
>
> (emphasis added).

Nothing in this portion of the restricted version would indicate that Congress had abandoned the unitary "transaction" concept. Moreover, retention of specific language obviating the need for independent proof of the insider's intention "in entering into such transaction" would indicate that Congress still meant to focus on insider status "prior to" the unitary transaction in question and not "simultaneous with" the initial step in that transaction, as suggested in *Stella* and later cases.

This construction offers a simple method of determining the application of section 16 (b) to a given situation. The question is whether one in a position of presumed access to inside information, that is, a director, officer, or a 10 percent stockholder of a corporation, combined a purchase and a sale of his company's stock, in any order, within a period of six months, thereby producing a profit. If the answer to this question is yes, the profit attributable to the short-swing transaction must be returned to the corporation. The logic of this test is clear: the position of director, officer, or beneficial owner results in a presumption of access to inside information, and the short-term nature of the transaction results in a presumption that this information motivated a coordinated short-term turn-over. Difficulties in proving either access or motivation justify the conclusiveness of these presumptions.

The final question is whether the language of the exemption clause precludes our construction of section 16(b). The exemption clause provides in pertinent part:

> This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved . . . .

Having in mind the purpose of the section as first drafted, there is little reason to believe that this clause was meant to *extend* coverage to situations where the purchase/sale or sale/repurchase could not have been motivated at the beginning of the transaction by inside information. The language of the clause is that of limitation and not of expansion.

More difficult is the question of whether the exemption clause requires a determination of beneficial ownership relative to each component of a short-swing transaction, that is, relative to the purchase and to the sale, regardless of which comes first.[12] The use of the word "both" is confusing in this regard. It is possible to read the word to refer to the separate components of the two types of short-swing transactions; this has been the prevailing view. It is also possible to read this word to refer to the two types of transactions *as transactions*. Neither construction is absolutely apparent. If Congress had intended the first construction it could easily have said "both at the time of the purchase and at the time of the sale." Similarly, if Congress had intended the second construction it could have said "both at the time of the purchase and sale transaction, or the sale and purchase transaction." It did neither, however, and we are left with the task of determining what construction will best serve the intended purposes of the statute. Given the legislative history of section 16(b) and the apparent logic of focusing all insider status inquiries on the period prior to the initiation of the short-swing transaction, we believe Congress intended by the language in question merely to indicate that in the case of both types of short-swing transactions, a person, to be charged with a section 16(b) violation, must only have had insider status prior to the *initial* purchase or sale.[13]

Since Gulf & Western did not occupy any section 16(b) insider position prior to the initial purchase of 3,000,000 shares of Allis-Chalmers common stock, its subsequent sale of this stock within six months did not trigger that section's conclusive presumption that a coordinated short-swing transaction based on inside information had taken place.

II

Turning to the September 30, 1968 acquisition of 248,000 shares of Allis-Chalmers common stock, it is not disputed that this purchase was executed at a time when Gulf & Western was a beneficial owner within the meaning of

[12] We are aware that the Supreme Court's opinion in *Reliance Electric* relies in large part on the fact that Emerson was not a beneficial owner at the time of the second sale, when it disposed of its remaining 9.6% interest in Dodge Manufacturing Company. We also note, however, that the Court in *Reliance* purposefully avoided a full analysis of the exemption clause, and in particular its application to the initial purchase in that case. 404 U.S. at 420-21. Our proposed construction of section 16(b) is in full harmony with the "congressional design of predicating liability upon an 'objective measure of proof'" 404 U.S. at 425, and would in every purchase/sale transaction yield the same result as that reached by the Court in *Reliance*. This is because in every purchase/sale transaction the "last" 10% held by a 16(b) defendant will have *pre-existed* any short-swing transaction, and thus will not be part of any 16(b) transaction for profit computation purposes. Under these circumstances we do not believe that *Reliance* forecloses our further analysis of the exemption clause or our development of an alternative construction thereof.

[13] Nothing in the legislative history or the generally accepted purpose of section 16(b) would suggest a reason for requiring a beneficial interest at the time immediately before or after the closing component of a short-swing transaction. Possession of more than a 10% interest at this late stage could in no way relate to the possibility of speculative abuse, since any speculatve plan would be formulated prior to the opening purchase or sale, as we have indicated. Furthermore, requiring a beneficial interest in connection with the closing component encourages a dual-meaning approach to the words "at the time of," as evidenced by the opinion of the Ninth Circuit in *Provident*. 506 F.2d at 614. Such a dual-meaning approach defies rational justification in terms of legislative intent, and makes the words themselves almost meaningless. Moreover, in a limited class of cases, such a requirement would allow a careful insider to speculate with 16(b) impunity. Thus, where a beneficial owner anticipated a downward market, he could sell his entire interest and buy back only 9.9% within six months. With regard to this transaction he would never have been a beneficial owner at the time of the repurchase regardless of how the words "at the time of" might be construed, and yet as to that transaction he would have satisfied both section 16(b) presumptions: a) he initiated the transaction when he was an insider, giving rise to a presumption of access to inside information; b) he completed the transaction within six months, giving rise to a presumption that he used inside information to coordinate the sale and repurchase.

section 16(b).[14] The defendant contends, however, that the Oppenheimer purchase was so much a part of the original take-over bid by Gulf & Western, and so profoundly influenced by alleged resistance to the take-over bid by Allis-Chalmers, that a "pragmatic" approach to the application of section 16(b) is required. It is also contended that pragmatic analysis of the facts in this case compels a finding of nonliability since Gulf & Western was never in fact a functional insider of Allis-Chalmers, and did not, as a factual matter, obtain any inside information in connection with the purchase and sale of the 248,000 shares.

This argument is based on the decision of the Supreme Court in *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973). Gulf & Western urges that *Kern* is precedent for the proposition that section 16(b) should be applied only in those situations in which the transaction in question "*may* serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based on access to inside information." 411 U.S. at 594. (emphasis added). In our view, the district judge properly determined that the rationale of the *Kern* case does not preclude liability under 16(b) for any profits realized by Gulf & Western as a result of the purchase and sale of the 248,000 shares obtained from Oppenheimer.

In *Kern*, defendant Occidental Petroleum Corporation had sought to initiate a merger with Kern County Land Company. This proved impossible, however, and Occidental decided to attempt a take-over of Kern through a tender offer to the Kern shareholders. In the course of the tender offer Occidental acquired well over ten percent of the outstanding shares of the target corporation.

[14] Under the construction of section 16(b) adopted in section I of this opinion, we need not pause to assess the significance of the fact that upon the execution of the sale of these shares to White Industries, Gulf & Western was no longer a beneficial owner within the meaning of the statute. It is interesting to note, however, that language in *Provident* would indicate that under the Ninth Circuit's view, liability would be avoided where, as here, one is not a beneficial owner "simultaneously with" the closing component of a section 16(b) transaction. 506 F.2d at 614-15 (quoted at pages 14-15 of this opinion).

While the offer was in effect, Kern engineered a defensive merger with Tenneco, Inc., involving an exchange of all shares of Kern stock for shares of Tenneco stock. Prior to the closing of the defensive Kern/Tenneco merger, Occidental executed a call option agreement with Tenneco whereby Tenneco acquired the right to purchase from Occidental all Tenneco shares which would be acquired by Occidental in return for its shares of Kern stock under the proposed defensive Kern/Tenneco merger. By its terms, this option was not exercisable until six months after the last acquisition of Kern stock by Occidental.

Subsequently, but within six months of the original acquisition of Kern stock by Occidental, the Kern/Tenneco defensive merger was closed. At this point Occidental became irrevocably entitled to receive Tenneco shares in exchange for its Kern stock. Occidental purposely did not exercise this right until Tenneco exercised its call option more than six months after the last acquisition of Kern stock by Occidental. Immediately upon the exercise of Tenneco's option, Occidental tendered its Kern shares and disposed of its newly acquired Tenneco shares by transferring them to Tenneco pursuant to the option agreement.

In holding that Occidental was not liable to Kern under section 16(b), the Supreme Court determined that neither the acquisition of the irrevocable right to exchange its Kern shares for Tenneco shares pursuant to the defensive merger, nor the execution of the option agreement with Tenneco in reaction to that merger constituted a "sale" by Occidental within the meaning of the statute. The Court pointed out that the exchange of shares was required by the terms of the defensive merger and thus was not a voluntary act attributable to Occidental. No evidence existed to indicate that Occidental had in any way participated in the merger negotiations between Kern and Tenneco, and the continuous, short-term nature of the tender offer precluded any reasonable opportunity for Occidental to have premised its decision to acquire shares in excess of ten percent on insider's knowledge of

the Kern/Tenneco merger negotiations.[15] Once the defensive merger "crystallized" Occidental was left with no real option regarding the conversion of its Kern shares into Tenneco shares. Had Occidental decided to avoid the conversion of its shares under the merger by disposing of the shares to an outside purchaser prior to consummation of the merger, this sale would have fallen clearly within the section 16(b) "sale" concept and "would have left Occidental with a prima facie § 16(b) liability." 411 U.S. at 600. In light of these facts the Court held that the involuntary conversion of Occidental's Kern shares into those of Tenneco did not constitute a section 16(b) "sale" of the Kern stock.

With respect to the option agreement, the Court initially observed that "the mere execution of an option to sell is not generally regarded as a 'sale'." 411 U.S. at 601. The Court then proceeded to examine the particular option agreement at issue to determine whether this agreement amounted to a "sale" within the meaning of section 16(b) in terms of its potential for speculative abuse in connection with the prior acquisition of more than ten percent of the stock of Kern Company. In its analysis the Court noted that the option was not on Kern stock at all, but on Tenneco stock which might be received in exchange for Kern stock in the event that the defensive Kern/Tenneco merger was approved. Implicit in this observation was the recognition that Occidental never intended to sell its Kern holdings so long as Kern County Land Company retained its separate corporate identity. In addition, the facts showed that Occidental had worked diligently to prevent this merger from proceeding to consummation. The option agreement was further limited by the fact that

[15] The Occidental tender offer was on a first-come, first-served basis. Originally the offer was for a total of 500,000 shares, and this offer was announced on May 8, 1967. By May 10, this original offer was fully subscribed. On the following day the offer was extended to encompass an additional 500,000 shares. The offer expired on June 8, 1967 with Occidental owning a total of 887,549 shares of Kern stock. Occidental achieved 10% ownership when it acquired 432,800 shares. Since the decision to extend the offer was made on May 11, one day after the original offer for 500,000 shares was subscribed—and in all probability one day after Occidental first became a beneficial owner—the possibility that Occidental used information gained as an insider as a basis for its extension of the tender offer was virtually non-existent. 411 U.S. at 584-85 & note 6.

it was a call option and therefore unenforceable by Occidental even if the defensive merger were in fact closed and shares exchanged. Given these facts the Court concluded that the execution of the option agreement was also not a section 16(b) "sale" of Occidental's Kern interests.

The purchase and sale of the 248,000 shares of Allis-Chalmers stock acquired from Oppenheimer is not even remotely comparable to the transaction in *Kern*. The question in *Kern* was whether the term "sale" as used in the statute should be construed to apply to two very unorthodox transactions. In resolving this question the Court pierced the form of the two transactions to determine whether in substance either of the transactions amounted to a sale. The Court did not suggest that ordinary, voluntary transactions commonly recognized as purchases and sales would not automatically trigger the application of section 16(b) in future cases as they uniformly have in the past. Indeed the Court specifically recognized that:

> [t]he statute requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information. 411 U.S. at 595.

In order to avoid this automatic rule under the *Kern* rationale, it would have to be shown 1) that either the purchase or the sale was an unorthodox transaction, and 2) that an analysis of the unorthodox transaction discloses no possibility of short-term speculative abuse.[16] The Oppenheimer purchase/sale transaction satisfies neither of these tests. The purchase of the Oppenheimer shares in Allis-Chalmers was a simple, voluntary purchase on the part of Gulf & Western. Certainly the fact that Gulf & Western used its own warrants rather than cash as consideration in this bargain does not render the purchase

[16] As the Supreme Court summarized in *Kern*:

> But the involuntary nature of Occidental's exchange, when coupled with the absence of the possibility of speculative abuse of inside information, convinces us that section 16(b) should not apply to transactions such as this one. 411 U.S. at 600.

unorthodox, and we do not understand Gulf & Western so to contend. Similarly, the sale of Gulf & Western's total interest in Allis-Chalmers to White was a simple, orthodox sale, albeit involving a rather complicated consideration element. Unlike the situation in *Kern*, there is nothing in the nature of these transactions which requires a judicial construction of the terms "purchase" or "sale," beyond giving these terms their commonly accepted meanings.

Moreover, even were we to assume that these transactions met the "unorthodox" test, nothing in the nature of these transactions precludes, or even reduces, the possibility of speculative abuse. The purchase from Oppenheimer was a planned business transaction, presumably undertaken as a profitable venture. Similarly, the sale to White was not involuntary, as in the case of a conversion into shares of another corporation pursuant to a defensive merger, nor was it conditional in any respect or tied to the future value of stock in a different corporation. On the contrary, at the time that Gulf & Western made its decision to purchase the 248,000 shares of Allis-Chalmers stock from Oppenheimer it was in a position to anticipate and control its future disposition of those shares. It voluntarily disposed of the shares within six months, *after* obtaining an indication from Allis-Chalmers' chairman that the future of that company did not look any too bright. The possibility certainly existed, therefore, that Gulf & Western's early disposition of its Allis-Chalmers shares was an attempt to avoid the effect of the predicted weakening of Allis-Chalmers' common stock, a prediction gained as an insider of that company. The application of section 16(b) is therefore automatic, and not in any way affected by a failure to prove up actual access to inside information, or improper use of such information.

III

Having found Gulf & Western liable for any profits realized from its purchase and sale within six months of the 248,000 shares of Allis-Chalmers stock obtained from Oppenheimer, we must determine whether the district court properly evaluated these profits. Allis-Chalmers contends that the district judge erred in his calculation of each element of damages thereby greatly reducing the liability of Gulf & Western.

A

With respect to the acquisition of the shares from Oppenheimer, the district court determined that the unregistered Gulf & Western warrants covered by that transaction should be evaluated at a per unit price of $15.92. This figure resulted in a total purchase price evaluation of $7,896,320.00 ($15.92 x 496,000 = $7,896,320.00). Allis-Chalmers points out that experts of both the defendant and the plaintiff evaluated the unregistered warrants at a much lower figure,[17] and that nothing in the record will support the $15.92 per share figure used by the district judge. It contends, therefore, that the value determination by the district court was clearly erroneous and should be set aside. We agree.

The district court's evaluation was the result of an erroneous assumption, namely, that a discount factor of fifteen percent which was recommended by two of the three expert witnesses did not reflect a full appraisal of the market value to be attributed to the guarantee by Gulf & Western relating to future registration of the 496,000 warrants. Gulf provided in its agreement with Oppenheimer that it would file a registration statement for the warrants (and related stock) on or before April 30, 1969, and in addition, that if it did not make effective a registration statement for these securities before December 31, 1968, it would guarantee Oppenheimer an average gross price per warrant of $13.50 for any warrants sold during the ninety days following the effective date of the registration statement. Also included in the agreement was a provision that in the event Oppenheimer should decide to sell the warrants under the guarantee, Gulf & Western would be given notice of the proposed sale and an opportunity for three business days to provide a buyer who would purchase the warrants from Oppenheimer at a higher price than the price to

[17] Plaintiffs' expert witnesses were Robert N. Hampton and Fred D. Stone. Hampton testified that considering all factors involved in the purchase agreement, a valuation per warrant of $14.25 would be proper, representing a discount of 9.5% from the low market trade on the closing date for identical registered warrants. Stone, also considering the entire agreement between the parties, testified that a range of from $12.92 to $13.70 would be accurate, representing a discount from low market of from 13% to 18%. Defendants' expert, Gabriel J. Danihel, on a similar basis, testified that a discount of 15% would be proper.

be obtained by Oppenheimer in its proposed sale. Each of the experts who testified on the subject of valuation of the unregistered warrants expressly indicated that his evaluation was based in part on the provisions of this guarantee. Each also expressed his final valuation in terms of a discount to be applied to the low market price for comparable registered Gulf & Western warrants being sold on the American Stock Exchange on the date of closing.

The district judge adopted a discount figure of fifteen percent as representative of the opinions of the experts and as realistic,[18] and applied this discount to the volume-weighted average price,[19] rather than the low price for registered warrants on the date of closing as urged by plaintiffs. He thereby arrived at a fair value per unregistered warrant of $13.69. Had the judge adopted $13.69 as the section 16(b) purchase price we would have no trouble affirming[20] as to this element of his calculation of damages.

[18] We find no substantial disagreement between the parties as to the propriety of this figure.

[19] The volume-weighted average price is determined for a given day by breaking the day's transactions into groups according to the price at which the security was traded, and then multiplying each price times the number of shares traded at that price, and dividing the total of these products by the total number of shares traded for the day. We discuss the propriety of using the volume-weighted average price in section III B, *infra*, in connection with the valuation of certain unregistered shares of White Consolidated Industries. That discussion applies to the use of the volume-weighted average price here, as well, since of a total of 29,600 warrants traded on the date of closing, only 700 (2.3%) were traded at the low market figure of $15⅞.

[20] Although Gulf & Western argues that the fact of non-registration does not or should not affect the *cost to it* of the warrants, and that the September 30, 1968 valuation should therefore equal the market value of registered warrants on that date, this argument ignores the value of money as a commodity. Gulf & Western elected not to purchase the Oppenheimer shares in Allis-Chalmers for cash. If it had possessed 496,000 registered warrants on September 30, 1968 it could have used these warrants and relied on their market value as reflected on the American Stock Exchange. It apparently had neither cash nor registered warrants, however, and therefore determined to use unregistered warrants. To Oppenheimer these warrants represented an allocation of capital to a non-liquid, speculative investment which would remain essentially non-liquid until registration on the American Stock Exchange. This accounts for the diminution in value to Oppenheimer attributable to the fact of non-registration. *See W. Fletcher, Cyclopedia of the Law of Private Corporations* § 8907, vol. 19, p. 67 (1959 ed.). On the other hand, Gulf & Western realized an immediate return for the non-registered warrants in the form of freely marketable Allis-Chalmers stock without the necessity of waiting the uncertain period

The district judge went on, however, to add to this "fair value" figure an increment of $2.23 as representing the value of the guarantee to register within three months, thereby attaining a final per unit valuation of the unregistered warrants of $15.92, or $.15 *more* than the low market transaction for registered warrants on the closing date and only $.19 less than the volume-weighted average price for that day for identical registered warrants. This was clearly error. Aside from the fact that the experts were nearly unanimous in their lower valuation of the unregistered warrants *with the guarantee* "for 16(b) purposes," and aside from the fact that Oppenheimer independently evaluated the warrants at $13.63 per warrant in a filing with the Securities and Exchange Commission, the addition of $2.23 to the conceded fair value of $13.69 per warrant does not withstand logical examination.

The effect of the guarantee as to Oppenheimer was two-fold. First, it provided an incentive for Gulf & Western to make its best efforts to attain early registration, thereby reducing the period of non-liquidity for Oppenheimer. Second, it provided a limited hedge against significant loss on Oppenheimer's investment in the event Oppenheimer determined to sell its warrants within a period of ninety days after the effective date of registration in the event the December 31, 1968 registration date was not met. It did not remove all risk, however, since if the early registration date was met, no guarantee would be effective, and similarly, if the market in the warrants remained rela-

[20] (Continued)

required for registration of its warrants. By doing this Gulf & Western was able to shift to Oppenheimer and avoid for itself any tie-up of capital during the period of non-registration. To use an analogy, Gulf & Western was able to obtain immediate payment for an unfinished product coupled with a promise to complete the production process. By doing so it avoided the cost of financing the Oppenheimer purchase during the interim between September 30, 1968 and the date of registration. It cannot be denied that the true cost of producing a marketable warrant is less when one is paid early in the production process rather than after the process is completed. Given an assumed constant market value for the completed product, one who is paid prior to completion need only receive an amount sufficient to produce, through investment, the actual market value of the product as of the date of completion. A discount for non-registration was therefore appropriate. *Cf. Security Options Corp. v. Devilliers Nuclear Corp.*, 472 F.2d 844, 846 (2d Cir. 1972).

tively constant or increased from September 30, 1968 through the ninety days after effective registration, Oppenheimer, if it retained its warrants, would no longer be protected by the guarantee.

Turning to Gulf & Western, the guarantee has other, more significant features. On its face, it gave Gulf & Western a choice between early registration and possible liability under the $13.50 guarantee provision. More importantly, however, it gave Gulf & Western an opportunity to limit its own costs in the event the $13.50 guarantee was invoked, by giving Gulf & Western a three-day period during which it could *itself* repurchase the warrants at the guarantee price.[21] If it elected to do so, Gulf & Western could have effectively converted its stock acquisition to a cash purchase with the payment of the purchase price delayed for a period of several months after delivery of the Allis-Chalmers stock. If this were to happen, Gulf's "cost" would have been limited to the cost of preparing the unregistered warrants (negligible), plus the cost of registration, plus the purchase price of $13.50 per warrant, minus the market value of the use of the $13.50 per unregistered warrant during the interim between the September 30, 1968 closing and the purchase back of the warrants.

This analysis makes it clear that the guarantee could not have eliminated the disparity between the market value of the registered warrants being traded on the American Stock Exchange and the fair value of the unregistered warrants used in the Oppenheimer transaction, and that far from presenting an additional and costly risk to Gulf & Western, the guarantee actually presented a method to limit the "cost" of the warrants to well below the volume-weighted market value of $16.1144 for similar registered warrants as reflected on the date of closing.[22] The record in this case clearly supports the

[21] There is no express limitation on repurchase by a corporation of its own warrants in the corporate law of Delaware. DEL. CODE ANN. tit. 8, §§ 157, 160.

[22] Gulf & Western voluntarily extended the guarantee period on March 18, 1969 when Oppenheimer gave notice of its intent to sell its warrants. The extension did not avoid liability under the guarantee, however, since during the extension Oppenheimer sold pursuant to proper notice. Gulf & Western made payment under the guarantee in the sum of $2,154,437.50 on June 5, 1969. Apparently Gulf & Western believed this the better alternative to simply purchasing the warrants themselves at the $13.50 figure.

$13.69 figure drawn from the opinions of the experts, and we therefore adopt this evaluation as properly reflecting the section 16(b) purchase price of the Allis-Chalmers shares obtained from Oppenheimer. The full purchase price of these shares is therefore $6,790,240.00 ($13.69 x 496,000).

B

Turning to the December 6, 1968 sale by Gulf & Western of its entire holding 3,248,000 shares of Allis-Chalmers common stock to White, we must determine the section 16(b) value of the total consideration received from White and the proportional amount of this total consideration attributable to the 248,000 shares obtained from Oppenheimer. The total consideration received from White consisted of $20,000,000 in cash, 250,000 unregistered shares of White common stock, and an unsecured six month promissory note from White in the face amount of $93,680,000 at an interest rate of eight and one-half percent. The district court valued the 250,000 unregistered shares of White stock at seventy-five percent of the volume-weighted average price of identical registered shares being traded on the New York Stock Exchange on December 6, 1968. The White note was valued at ninety-five percent of its face amount. Allis-Chalmers says that the district court erred in both determinations.

Regarding the unregistered White common stock, Allis-Chalmers contends that the twenty-five percent discount, even if proper in amount, should have been applied to the high market price for identical registered shares traded on December 6, 1968 rather than to the volume-weighted average price for that day. The high price was $42.50 while the volume-weighted average price was $40.3458.[23] It is urged

[23] Curiously, Allis-Chalmers seems to contend at one point in its brief that a discount of 28% rather than 25% should have been employed. Thus, in its table of computations it figures on the basis of $42.50 discounted by 28% times 250,000 shares. The table shows a correct product of $7,650,000 for these figures which is then compared to the district court's figure of $7,613,493 to arrive at an alleged improper diminution in profit of $36,507 as a result of the judge's failure to use the $42.50 rather than the volume-weighted average price. But more significant is the district judge's use of a discount of 25% rather than the 28% shown in the Allis-Chalmers table. Had Allis-Chalmers used the 25% figure in its table, it would have reflected a

that use of the higher valuation was required under the rationale of *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), and *Smolowe* v. *Delendo Corp.*, 136 F.2d 231 (2d Cir. 1943), *cert. denied*, 320 U.S. 751 (1943), in order "to squeeze all possible profits" from the transaction. 136 F.2d at 239. While we agree with the underlying principle of the *Bershad and Smolowe* cases,[24] we are unable to agree that use of the volume-weighted average price in this case offended that principle.

Smolowe was a case involving the problem of trade-matching. A section 16 (b) insider had engaged in numerous purchases and sales within a six month period and the question there was which purchase to match with which sales in order to compute section 16 (b) profits. After rejecting the possibility of using an "identity" test or the related "first-in, first-out" rule as being ineffective in the case of a large stockholder who could choose his opportunities to sell specific certificates and avoid section 16 (b) liability altogether, and after rejecting the notion of averaging all purchases and all sales within a six month period as effectively allowing a set-off of losses within the period in contravention of the provision in section 16 (b) that "any" profit be recovered, the court concluded:

> The statute is broadly remedial . . . . Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty . . . . The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out—within six months—as applied by the district court.

[23] (Continued)
diminution in "profits realized" resulting from the use of the volume-weighted average price (rather than the high market price) of $355,257 rather than the $36,507 figure. In the conclusion of its brief Allis-Chalmers in fact does combine the 25% discount with the $42.50 figure to reflect the true impact of the court's use of the volume-weighted average price.

[24] Plaintiffs also cite *Anderson* v. *Commissioner*, 480 F.2d 1034, 1037 (7th Cir. 1973), in support of their position, but this tax case adds nothing more than a general citation with approval of the *Bershad* and *Smolowe* cases.

> We affirm it here, defendants having failed to suggest another more reasonable rule. 136 F.2d at 239. (footnote omitted).

Nothing in this language suggests that the "lowest price in, highest price out" rule was meant to have application in cases where only one purchase or one sale has taken place so that trade-matching is not a problem, and the last sentence of the passage clearly indicates that even in trade-matching situations the rule is not absolute if a more reasonable method is suggested.[25]

Bershad did not involve valuation at all, but revolved around the question of whether the granting of a certain "option" to purchase stock amounted to a sale of that stock for section 16 (b) purposes. In determining that it did, this court noted the broad purpose of the section:

> Section 16 (b) was designed to prevent speculation in corporate securities by "insiders" such as directors, officers and large stockholders. Congress intended the statute to curb manipulative and unethical practices which result from the misuse of important corporate information for the personal aggrandizement or unfair profit of the insider. Congress hoped to insure the strict observance of the insider's fiduciary duties to outside shareholders and the corporation by removing the profit from short-swing dealings in corporate securities. Conversely, Congress sought to avoid unduly discouraging bona fide long-term contributions to corporate capital . . . .
>
> In order to achieve its goals, Congress chose a relatively arbitrary rule capable of easy administration. The objective standard of Section 16 (b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties

[25] Plaintiffs contend that *Newmark* v. *RKO General, Inc.*, 305 F. Supp. 310, 314 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 348 (2d Cir. 1970), *cert. denied*, 400 U.S. 854 (1970), represents an application of the "general rule" in a non-trade matching situation. While it is true that the rule of "highest in" was there used, it is also clear that the "highest in" valuation was not objected to on appeal, 425 F.2d at 357, and extensive analysis of the use of this figure was never urged.

> in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect. 428 F.2d at 696.

Though the court cited *Smolowe* in support of these statements, it cannot be argued that this general statement of purpose somehow enshrined in the law of this circuit a flat rule of lowest price in, highest price out for all valuation problems under section 16 (b). Valuation simply was not in issue in *Bershad*.

In this case, authenticated copies of the Fitch Report for December 6, 1968 trading in White common stock on the New York Stock Exchange disclosed that of a market volume of 31,300 shares traded for the day, only four hundred shares were traded at the market high price of \$42.50. This represents a scant 1.277 percent of the market in White shares. By far the largest single sale on December 6, 1968, a trade of 7600 shares, reflected a price of \$40.00—significantly less than the volume-weighted average price of \$40.3458. In addition, Allis-Chalmers' own expert testified that normal accounting procedure was "to figure . . . in terms of the average of the high and low price in a given day rather than one end or the other," and that he had made his discount computations from the high market figure in this instance only at the instruction of counsel for Allis-Chalmers.

We have held that the goal of squeezing out all profits "does not require a court to adopt a completely unrealistic interpretation of the market." *Mueller* v. *Korholz,* 449 F.2d 82, 87 (7th Cir. 1971), *cert. denied,* 405 U.S. 922 (1972). We find no error in the determination of the district court that it would be unreasonable and unrealistic here to attribute a market value of \$42.50 per share to a block of 250,000 shares of White common stock acquired on December 6, 1968. On the basis of the Fitch Report alone it would be difficult to reach a different conclusion. Section 16 (b), while it was intended to be thoroughgoing, was surely not intended to reject accuracy in favor of punitiveness.

Looking finally to the district court's valuation of the unsecured White note, we must determine whether the discount of five percent of the face amount of the note was properly applied. This discount was intended to account for the risk factors involved in a note of this size and to

produce a value reflecting what "the disinterested but available third party investor" would pay for the note on December 6, 1968. In adopting the ninety-five percent valuation figure the court rejected undisputed evidence that the note was in fact paid in full with interest by White three and one-half months after closing. The question therefore becomes whether the difference between the market value of the note and the actual value the note produced for Gulf & Western falls within the statutory phrase "any profit realized." We have no hesitation in holding that it does.

As we have previously noted, section 16 (b) was designed to curb misuse of inside information by removing profit from a class of transactions deemed by Congress to present an intolerable invitation for such abuse. *Reliance Electric Co.* v. *Emerson Electric Co.,* 404 U.S. 418, 422 (1972). All transactions within the class are tainted with a presumption that inside information has been misused, and the presumption precludes any defense based on the showing of a "clean heart" by the section 16 (b) defendant. *Id,* at 424 n. 4; *Newmark* v. *RKO General, Inc.,* 425 F.2d 348, 353 (2d Cir. 1970), *cert. denied,* 400 U.S. 854 (1970). It should be noted, however, that the statute does no more than remove the profit from such transactions. It does not inflict an affirmative fine or penalty. Thus, one who is forced by personal circumstances into a section 16 (b) transaction does not face financial ruination, but merely the prospect that his short-term investment of capital has not produced a positive gain.

Given the broad remedial purpose of section 16 (b), its limited impact, and the intent of Congress in drafting this section to "eradicate speculative abuses by reducing difficulties in proof," *Bershad* v. *McDonough,* 428 F.2d at 696, we hold that in transactions involving debt obligations of an amount certain, evidence of payment in full, if available at the time of trial, should control the determination of "profit realized."[26] We cannot help but wonder whether

[26] The evidence showed that the prime rate of interest at the time of this transaction was 6½%. Expert testimony indicated that the nature of the note and the circumstances surrounding the sale to White justified the higher 8½% rate agreed to by the parties. There has been no contention that the increment over the prime rate was used to conceal 16(b) profits by artificially reducing the face amount of the note.

Gulf & Western's present belief that estimated market value at the time of closing is the only proper measure of 16 (b) liability could have withstood the strains of a situation where White had in fact defaulted on the note completely. In any event, a rule of evaluation which looks to the realities in such situations will avoid the possibility that real profits will escape the reach of the statute or that non-existent profits will be "recovered." We believe this to be no more nor less than the language of the section requires.

IV

To summarize, the consideration received from White Industries is properly evaluated as follows: $20,000,000 in cash, plus $7,564,837.50 in unregistered White common stock (250,000 × $40.3458 × .75 discount factor), plus $93,680,000 in the form of the White promissory note, for a total consideration of $121,244,837.50. This figure must be prorated to reflect the portion attributable to the Oppenheimer purchase. A simple method of doing this is to divide the total consideration by the total number of shares sold ($121,244,837.50 ÷ 3,248,000 = $37.3291) and then multiply the resulting per-share figure by 248,000. Using this method a proportional consideration for the 248,000 shares of $9,257,616.80 is produced. Substracting the acquisition price of $6,790,240.00 from this figure yields a gross profit allocable to the Oppenheimer transaction of $2,467,-376.80. From this figure must be deducted the stipulated expenses incurred by Gulf in connection with the Oppenheimer purchase in the amount $1,696.33. The resulting net profit for section 16 (b) purposes is $2,465,680.47.

The judgment of the district court is therefore reversed in part and remanded for entry of judgment in favor of Allis-Chalmers in the amount of $2,465,680.47. Each party is to bear its own costs.

A true Copy:

Teste:

....

Clerk of the United States Court of Appeals for the Seventh Circuit

BEST COPY AVAILABLE

APPENDIX B

Opinion of the United States District Court for the Northern District of Illinois

IN THE

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ILLINOIS

EASTERN DIVISION

No. 70 C 513 and No. 69 C 627

ALLIS-CHALMERS MANUFACTURING COMPANY,
a Delaware corporation,

Plaintiff,

v.

GULF & WESTERN INDUSTRIES, INC.,
a Delaware corporation,

Defendant.

This action was commenced on January 6, 1969 in the United States District Court for the Eastern District of Wisconsin by plaintiff, Allis-Chalmers Manufacturing Company, now Allis-Chalmers Corporation (hereinafter referred to as "Allis"). Plaintiff seeks to recover alleged short-swing profits from Gulf & Western Industries, Inc. (hereinafter referred to as "G&W") under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78 p (b)) alleged by plaintiff to have been realized by G&W as a result of two purchases in July and September of 1968 aggregating 3,248,000 shares of Allis common stock and the subsequent sale of these shares on December 6, 1968.

Pursuant to a motion by G&W under 28 U.S.C. § 1406(a) that venue was improper in the Eastern District of Wisconsin the case was transferred to this District. *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, 309 F. Supp. 75 (E.D. Wis. 1970). At the same time G&W commenced an action in this Court for declaratory judgment. *Gulf & Western Industries, Inc.* v. *Allis-Chalmers Manufacturing Company,* (69 C 627). On March 23, 1970 the two actions were consolidated and this Court ordered the consolidated action to proceed on the basis of Allis' Amended Complaint which was originally filed on February 19, 1970 in the Eastern District of Wisconsin.

Allis, a corporation organized under the laws of the State of Delaware, having its principal office in West Allis, Wisconsin, is a manufacturing company engaged in the manufacture of agricultural, construction, industrial and electrical machinery and related equipment.

G&W, a corporation organized under the laws of Delaware, having its principal office in the City and State of New York, is a diversified company engaged in a variety of businesses, including manufacturing, distribution, leisure time operations and the production of minerals, metals and certain agricultural and consumer products.

During the period June 30, 1968 and December 31, 1968 there were between 10,364,102 and 10,410,292 shares of Allis common stock issued and outstanding. 3,000,000 of these shares were purchased by G&W through an Exchange Offer made to all Allis shareholders, and 248,000 shares of them were bought from the Oppenheimer Fund, Inc.

On May 7, 1968 G&W publicly announced to all Allis shareholders that it would make an Exchange Offer in accordance with a registration statement and prospectus filed and published as required by the Securities Act of 1933. G&W proposed to purchase on a pro-rata basis up to

3,000,000 such shares. Under the proposed offer Allis shareholders would receive for each share of Allis common stock: (a) $11.50 in cash, (b) $12.50 principal amount of a 6% subordinated 20-year nonconvertible debenture ("the G&W 6% Debenture"), and (c) 9/10 of a 10-year registered warrant to purchase G&W common stock at $55 per share ("the G&W Warrant").

There is a major dispute as to the date on which the purchase of the 3,000,000 shares of Allis common stock occurred. G&W contends that the date was July 29, 1968; Allis contends the date was July 31, 1968. Both parties agree that G&W's purchase of the additional 248,000 shares of Allis' common from the Oppenheimer Fund took place later on September 30, 1968. In exchange for these 248,000 shares G&W gave Oppenheimer 496,000 unregistered G&W warrants.

On December 6, 1968 G&W sold its entire block of 3,248,000 shares of Allis' common stock to White Consolidated Industries, Inc. (hereinafter referred to as "White") in exchange for: (a) 250,000 unregistered shares of White common stock, (b) White's unsecured 8½% promissory note in the face amount of $93,680,000 payable in six months, and (c) $20,000,000 in cash.

Allis now seeks to recover what it alleges are short-swing profits of $16,305,251 which it contends G&W realized from its two purchases in July and September 1968 and its subsequent sale in December of 1968 of the 3,248,000 shares of Allis common stock. The total sales price is alleged to have been $121,330,000. Allis' position is that the purchases and the sale both occurred within less than six months. Allis claims that the amount of the sale together with the dividends received by G&W during this less than six month period, minus its stipulated cost of acquiring and selling the 3,248,000 shares constitute the amount of profit. Allis also

seeks to recover interest at 6% on G&W's profits from the date of sale, December 6, 1968, to the date of entry of judgment.

G&W's Answer to the Amended Complaint denies all material allegations of the Complaint, and specifically alleges, *inter alia*, that G&W was not a beneficial owner of more than 10% of Allis' stock at the time of its acquiring through the Exchange Offer the 3,000,000 Allis shares, and that this is required by Section 16(b). G&W contends that since its acquisition of the 3,000,000 Allis shares was pursuant to an Exchange Offer regulated by the Securities Act of 1933 the transaction would be excluded from the purpose of Section 16(b). G&W further charges that the sale of its 3,248,000 Allis shares was induced by "duress and hostility" to G&W, originating with Allis and inflamed through Allis' encouragement of Federal Trade Commission proceedings against G&W. G&W thus denies liability. But then, going further, G&W claims that even if there is liability, it realized no profit from the transactions and there would be no money due to Allis as a result of this action.

Liability

The jurisdiction of this Court is asserted under Section 27 of the Securities Exchange Act of 1934 (15 U.S.C. 78aa).

Section 16(b) of the Act states as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of

> less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

Section 16(b), thus, provides that liability attaches to 10% beneficial owners who are such: ". . . both at the time of the purchase and sale, or the sale and purchase of the security involved. . . ."

G&W contends in one of its affirmative defenses that as to the 3,000,000 shares of plaintiff's common stock acquired by G&W pursuant to the Exchange Offer, G&W is not liable to Allis for any profits that may have been realized upon

the sale to White since at that point in time when G&W acquired the 3,000,000 shares G&W was not a beneficial owner of more than 10% of Allis' equity security within the terms of the statute. This would mean that it then *became* the owner of more than 10%, and only a subsequent acquisition would bring the statute into play.

Allis, however, contends that on an *initial* purchase of more than 10% one becomes such a holder of more than 10% of the stock of a company as to trigger the applicability of Section 16(b). To bolster its contention that one becomes subject to Section 16(b) at the time of the purchase which turns one into a 10% beneficial owner irrespective of the percentage of his prior holdings, if any, Allis quotes from the recent decision in *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 584 (May 7, 1973):

> "Unquestionably, one or more statutory purchases occurs when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders."

In the *Kern County* case defendant, Occidental Petroleum Corporation, made a tender offer for shares of the Kern County Land Company (hereinafter referred to as "Old Kern"). That offer became effective on May 8, 1967 and by May 10 more than 10% of the shares had been tendered. The Court found that Occidental became a beneficial owner within the terms of 16(b) when pursuant to its tender offer it purchased more than 10% of the outstanding shares of Old Kern.

G&W relies upon *Kern County* also. This is because in that case a tender offer was involved, which like the exchange offer here, raised the question of whether or not the

nature of the purchase was reached by the statutory definition.[1]

A careful analysis of the case law including *Kern County* leads me to the conclusion that G&W by its initial purchase, became a beneficial owner of more than 10% of Allis' stock. In construing the words "at the time" as used in the statute the Court in *Stella* v. *Graham-Paige Motors Corp.*, 104 F.Supp. 957 (S.D.N.Y. 1952), *aff'd in part, remanded in part*, 232 F.2d 299 (2d. Cir.), *cert. denied*, 352 U.S. 831 (1956) said as follows at 960:

---

[1] Pertinent language in the decision includes the following from 593-595:

> "Although traditional cash-for-stock transactions that result in a purchase and sale or a sale and purchase within the six month statutory period are clearly encompassed within the purview of § 16(b), the courts have wrestled with the question of inclusion or exclusion of certain 'unorthodox' transactions. The statutory definitions of 'purchase' and 'sale' are broad and, at least arguably, reach many transactions not ordinarily deemed a sale or purchase. In deciding whether borderline transactions are within the reach of the statute, the courts have come to inquire whether the transactions may serve as a vehicle for the evil which Congress sought to prevent—the realization of short-swing profits based upon access to inside information—thereby endeavoring to implement congressional objectives without extending the reach of the statute beyond its intended limits. The statute requires the inside, short-swing trader to disgorge all profits realized on all 'purchases' and 'sales' within the specified time period, without proof of actual abuse of insider information, and without proof of intent to profit on the basis of such information. Under these strict terms, the prevailing view is to apply the statute only when its application would serve its goals. [W]here alternative constructions of the terms of §16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders. *Reliance Electric Co.* v. *Emerson Electric Co., supra*, at 424. See *Blau* v. *Lamb*, 363 F.2d 507 (CA2 1966), cert. denied, 383 U.S. 1002 (1967). * * * [Thus] "[i]n, interpreting the terms 'purchase' and 'sale', courts have properly asked whether the particular type of transaction involved is one that gives rise to speculative abuse."

"... if the words 'at the time' are construed to mean 'simultaneously with' a shareholder would become subject to the provisions of §16(b) as soon as his ownership exceeded 10% of the outstanding shares. This construction would be consistent with the declared purpose of the statute to prevent the unfair use of inside information by officers, directors, or stockholders owning more than 10% of the equity stock."

Through the years since the *Stella* decision the Courts have followed its thinking in construing the words "at the time of the purchase and sale" to apply to shareholders immediately upon their acquisition of more than 10% of a corporation's securities. In *Bershad* v. *McDonough*, 300 F.Supp. 1051 (N.D.Ill. 1969) *aff'd*, 428 F.2d 693 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971), as in *Kern County, supra*, the Court was concerned with whether the granting of an option was a sale (the back end of the transaction) within the confines of Section 16(b). However, it is clear that the Courts would not have concerned themselves with that issue had they first not reasoned that Section 16(b) liability turned on an initial acquisition exceeding 10% serving to set in motion the 6 month period. In accord with these cases are the holdings in *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972); *Blau* v. *Lamb*, 363 F.2d 507 (1966), *cert. denied*, 385 U.S. 1002 (1967); and *Newmark* v. *RKO General, Inc.*, 425 F.2d 348 (1970), *cert. denied*, 400 U.S. 854 (1970).

On the facts before me, I conclude that G&W became a beneficial owner of more than 10% of Allis' common stock at the time of its purchase, by tender offer, of the 3,000,000 shares of Allis' stock. However, G&W argues that even if

it became a 10% owner of Allis' common stock at the time it acquired by tender offer almost a third of Allis' equitable ownership and sold the whole of it within six months, it is exempt from the operation of Section 16(b) because the purchase was "unorthodox" and "unorthodox" transactions do not involve the type of abuse Section 16(b) was enacted to prevent.

G&W presents a strong argument for the proposition that its initial acquisition of the Allis shares by an Exchange Offer was not the traditional cash-for-stock purchase that Congress considered in passing Section 16(b). Rather, G&W contends, it was a hybrid type of transaction with unique characteristics closely resembling a merger. G&W says that it would be erroneous to consider the legal consequences of G&W's acquisition of the stock apart from the disclosure process with which it alleges "it was inextricably connected." The argument is that Exchange Offers (as distinct from cash transactions) are surrounded by numerous legal safeguards which are designed to guarantee full disclosure to all shareholders and thus by their very nature are unsuited to short-swing speculation based on inside information.

In effect, the argument is that since the acquisition was conducted in accordance with the methods established by the Securities and Exchange Commission and Congress, i.e., pursuant to a registered Exchange Offer and by a Prospectus, G&W was not automatically an insider nor was there any possibility of abuse as a result of the nature of the transaction. Its offer, G&W contends, was subject to the prohibition against the use of any Prospectus (or Registration Statement) which contained "any untrue statement of fact or omission of a material fact required to be stated * * * or necessary to make the statements therein not misleading." Such prohibition appears in a

number of sections of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77l, 77q, 77x. Accordingly, G&W maintains, it caused all material information regarding Allis to be released to the public and placed in the hands of each Allis shareholder and that these actions afforded all parties to the proposed exchange an equal informational footing, eliminating thereby any advantage to G&W.

In opposition to this contention Allis ignores certain words of *Kern County*, "unorthodox sale—not a sale within the meaning of 16(b)", and argues that an unfettered reading of the language of Section 16(b) makes it clear that the statute does not require any showing that an insider had inside information in order for liability to attach. The suggestion that full and truthful disclosure of what is known is required by some other necessary proceedings, according to Allis, creates no defense to the charge that there was an actionable purchase.

It is true that the court in *Kern County* found that an unsuccessful takeover bidder who converted shares of the target company into the merged entity's shares was not liable for short-swing profits when it was found that there had been no opportunity for speculative abuse. The target corporation, Old Kern, had vigorously opposed Occidental's takeover bid and to thwart such a takeover had arranged a "defensive merger" with Tenneco. Due to the merger of Old Kern and Tenneco, Occidental was virtually forced to exchange the Old Kern shares that it had acquired by its tender offer for those of Tenneco. The successor corporation to Old Kern brought suit to recover the alleged Section 16(b) profits realized by Occidental. The court concluded that the transaction having been forced upon Occidental did not constitute a "sale" within the purview of Section 16(b). The court noted that the merger left Occidental with no appraisal rights under California laws; but that any other sale of Old Kern shares for cash before the merger closed "would have left Occidental with a prima facie § 16(b) liability." *Supra* at 600.

I am convinced that with these words the Supreme Court recognized that where, for example, a purchase carries sufficent indicia of full disclosure of all information available to the purchaser, and its sale is an economically or legally coerced involuntary act the transaction is not intended by Congress to be unlawful; but that when the sale is clearly voluntary a prima facie Section 16(b) violation would exist. When we on the trial bench try to facilitate our determination by limiting liability to simple categories, such as "orthodox" and "unorthodox", we may easily blind ourselves to the kinds of abuses to which Congress directed 16(b). The 1934 Senate Report on Stock Exchange Practices (*Senate Comm. on Banking and Currency*), Stock Exchange Practices, S. Rep. No. 1455, 73rd Congress, 73 Cong. 2d Sess. 55 (1934) stated:

> "Among the most vicious practices unearthed at the hearings before this subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations * * *. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors or officers, exercise sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others."

Even though *Kern County* is a clear repudiation of the "cold turkey" application of statutory liability in 16(b) cases, nowhere in *Kern County* does the Supreme Court take out of 16(b) its application to a short-swing transaction just because there was in fact no access to inside informa-

tion. It leaves the statute applicable to types of transactions that give "rise to speculative abuse". (*Kern County* at 595.) Under *Kern County* (594 fn. 26) the language of this Circuit in *Bershad* v. *McDonough*, 428 F.2d 693 (7th Cir. 1970), was confirmed. Then it went one step further. It announced a flexible "possibility of abuse" test to be applied to each case on the facts regarding its questioned transaction. The specific transaction itself must permit the possibility of or potential for abuse. (*Kern County* at 595.)

The question is whether or not an outsider becoming a prima facie insider, such as defendant, by virtue of a tender offer to purchase one third of plaintiff's common stock, under the circumstances of this case, engages in that type of transaction which Congress determined gives rise to the possibility of or potential for speculative abuses. By virtue of the nature and amount of the purchase, such purchaser generally places himself or itself in a position to at least exercise substantial influence over the decisions of the corporation, if not control. From this position information can be acquired not otherwise available to the public. Stock value changes can be reliably anticipated if not maneuvered. The desirable speculative character of a free market can be wrecked by the cumulative effect of a substantial amount of such piracy. The danger, of course, in each instance, is not easily established by evidence of actual manipulation or intent to manipulate.

Some corporations have as their primary occupation dealing in the stock of other corporations. Some buy and sell units of corporate control for profit. It seems to me that irrespective of whether the purchase under these circumstances is handled in an "orthodox" or an "unorthodox" manner, it can constitute one of the types of conduct which Section 16(b) was intended to reach.

This does not mean that Congress sought by this law to stop or even dissuade corporations from using their equity for moving in and out of positions of control or effective influence in other corporations, either for the purpose of investment or the purpose of acquiring on a trial and error basis absorbable corporate operations. The statute does intend to include corporate conduct out of which buying and selling for profit from an insider's perspective can occur. The evidence in the case before me shows defendant, G&W, as having engaged in a substantial number of transactions involving the purchase and sale of controlling interests in other corporations.[2] There is nothing in the evidence to establish that G&W's acquisitions and dispositions were for the purpose of gaining inside information to be used selling stock positions in corporations for profit, or that it actually did have inside information when it bought or sold. I am confident that the greater weight of the evidence presented to me does not establish that G&W had inside information of the character contemplated by Section 16(b) either before or after its purchase of Allis. But I am convinced that its position both at the time of the purchase and at the time of the sale was such as would, in many such situations, per-

---

[2] Its chief executive officer, when asked to confirm or reject a statement appearing in the February 15, 1973 edition of the Wall Street Journal, stated that he "would not reject the statement." The statement was that, from 1958 through 1968:

> "* * * G&W acquired about 130 companies, usually using its own securities or packages of its securities and warrants to buy the companies. At first the acquisitions were complementary with G&W's main lines of business, but later it branched out in all directions. The big year was 1968 when 23 acquisitions came under G&W's wing. * * * G&W that year similarly withdrew from stock positions in other large companies—Armour and Co., Allis-Chalmers Manfg. Co., and Sinclair Oil Corp. In fact over the years, G&W has bought in and out of companies both for investment reasons and for the purpose of acquisition and complete control."

mit access to information not otherwise available to the general public.

Allis failed to establish that G&W did have inside information both at the time of the purchase and at the time of the sale. What was shown was that in May of 1968 G&W's president was told by the head of a California investment firm that he had encouraged an investment firm to seek a merger with Allis; that Allis had been interested in being a part of a profitable merger; that the investment company and Allis had entered into a preliminary agreement to merge, but that the plan fell through because the investment firm believed a heavy manufacturing business inherently risky. This cannot be considered the type of inside information to which the statute refers. In addition, what was shown was that in September of 1968, before G&W sold its Allis stock, Allis' president told G&W's president that Allis' performance during that quarter of the year was extremely poor and that its earnings had declined sharply, but the inference to be drawn from this was that Allis sought to discourage G&W's retention of its stock position in Allis. Other information given G&W by Allis was almost contemporaneously made public.

G&W asserted as an affirmative defense the *absence* of inside information; but here again I find the facts insufficient. A fact does not exist here which is found in other cases in which this affirmative defense has succeeded. The missing fact is that plaintiff's conduct locked the defendant outside so effectively that the defendant could not have acquired inside information had it wanted to. This is what happened in *Kern County*, and in *Gold* v. *Sloan*, 486 F.2d 340 (4th Cir. 1973).

I further find the facts insufficient to establish as an affirmative defense that G&W was *compelled* to sell its stock in Allis before the expiration of the statutory period. Occidental was not only locked out in *Kern County*, but under

the circumstances was left no realistic alternative to disposing of its stock in Old Kern. Its only alternative would have left it with a prima facie 16(b) liability. Of the same order was the circumstance which compelled Scurlock in *Gold* v. *Sloan* to acquire the Susquehanna stock, part of which he sold within six months. G&W was here not *caught* in a merger. The one clear-cut defensive tactic of Allis, slashing its quarterly dividend in half after G&W had acquired one third of its common stock, as offensive as G&W may have felt it, was nevertheless not an act which compelled a sale some fifty odd days before the end of the statutory period.

Valuation

Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78(b)), provides that "for the purpose of preventing the unfair use of [inside] information," the beneficial owner shall pay over to the complaining corporation any profit realized by the purchase and sale. What then is the amount, if any, Allis is entitled to be paid by G&W is the remaining question. Allis contends that the amount is $16,305,251, with additional interest to the date of the entry of judgment. G&W contends that there was no profit, but rather a loss, and that Allis would be entitled to nothing.

The issue of the amount of profits to be accounted for where there is a 16(b) liability calls into play, when the consideration given or received is other than cash, certain principles of valuation. Were the consideration given and received cash only, the problem would be a simple one; but in most of these cases it usually is not just cash. Most of the cases under 16(b) cited by the parties in their briefs, in which liability had been found, involved consideration other than cash.

In this case the purchases were made with some cash, but principally with G&W warrants and debentures; and the sale was made for some cash, but principally for certain unregistered shares of common stock of White, and an unsecured six month corporate promissory note. Valuations of these other-than-cash considerations was the matter to which both sides were requested to and did direct much of their attention in testimony, exhibits and argument. The testimony and opinions of expert witnesses was presented at great length by both sides. Were the position of the plaintiff and its experts accepted completely, the defendant would be accountable for $12,741,788 in profits, for dividends and for interest from the date of the sale to the date of this decision. Were the position of the defendant and its experts accepted completely, it would be found that the defendant, through no fault of its own, lost $11,545,566 (if not $13,699,993) in the purchase and sale. The differences of more than 30 million dollars between the positions of the parties and their experts must be resolved by applying to the facts basic principles of valuation derived from authorities in the field of securities and accounting, and from cases interpreting valuations in 16(b) cases.

The Court itself must determine the fair market value or the fair value (in the absence of a market) of the consideration given up and received in a 16(b) case. Real or actual values, as in other cases, may require investigation of the affairs of the corporations and businesses involved; but the situs of the 16(b) valuation is the actual or presumed market place. *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984, 990 (2nd Cir.) cert. denied 332 U.S. 761 (1947).

Where in determining valuation two or more interpretations may equally be drawn from the same facts, the Court may adopt the one least favorable or most favorable to the defendant as the relative equities of the parties dictate; but

in doing so the Court is not required to adopt a completely unrealistic interpretation of the market. *Mueller* v. *Korholz*, 449 F.2d 82, 87 (7th Cir. 1971). One of the major disagreements between the parties in this case is the plaintiff's insistence that in 16(b) cases, valuations always must be read in the light least favorable to the defendant or most favorable to the plaintiff.

The concept of maximizing profit by using such theories as "lowest in and highest out" as espoused in the 1943 decision of the 2nd Circuit in *Smolowe* v. *Delendo Corporation*, 136 F.2d 231, 239, is not the law in this (7th) Circuit. In *Mueller*, *supra* at 87, we are admonished not to adopt a completely unrealistic interpretation in the name of advancing the Congressional purpose. In that case the Seventh Circuit was confronted with the problem of valuing the defendant Korholz's holdings of "Gypsum" stock traded in the over-the-counter market. No evidence was presented of actual trades on the date in question, but there was evidence of dealers "making a market" in Gypsum stock. Their quotations ranged from 6 to 6¾ on the "bid" side and from 7¼ to 7⅛ on the "asked" side. This meant that the best bid Korholz could have received from his shares was 6¾. As the Seventh Circuit explained, the plaintiff contended:

> " * * * as a matter of law that the low bid price of $6.00 was the only acceptable evidence of value because the policy of § 16(b) requires the Court to adopt an interpretation of the facts that will 'squeeze out all possible profit.' *Cf. Smolowe* v. *Delendo Corp.*, 136 F.2d 231 (2 Cir. 1943)."

Then explaining away the language of the Second Circuit, the court in *Mueller* went on to say at 87:

> "The comment in that case [Smolowe; supra] may guide a court's choice between two reasonable interpretations of the facts. *It does not require a court to adopt a completely unrealistic interpretation of the market.*" (Emphasis added.)

The court thereafter proceeded to affirm a valuation based not on $6.00 the low bid, nor even on the $6.75 best bid, but on a $6.875 "average price or value" on the relevant date.

There are numerous cases in which courts have chosen either the high or low figure for what appeared to be punitive purposes. *Blau* v. *Lamb*, 242 F.Supp. 151 (S.D. N.Y. 1965), rev'd and aff'd in part, 363 F.2d 507 (2 Cir. 1966), cert. denied 385 U.S. 1002 (1967); *Marquette Cement Mfg. Co.* v. *Andreas*, 239 F.Supp. 962 (S.D.N.Y. 1965); *Gratz* v. *Claughton*, 187 F.2d 46 (2d Cir.), cert. denied, 341 U.S. 920 (1951); *Heli-Coil Corp.* v. *Webster*, 222 F.Supp. 831 (D.N.J. 1963), aff'd as modified, 352 F.2d 156 (3d Cir. 1965); *Blau* v. *Lehman*, 173 F.Supp. 590 (S.D.N.Y. 1959), aff'd 286 F.2d 786 (2 Cir. 1960), aff'd, 368 U.S. 403 (1962). But it appears to me that in those cases the trial courts must have been without evidence from which realistic values might have been computed. As a result of evidentiary default, and faced with a decisional necessity, they resolved the issue through "stop-gap" application of Congressional purpose. *Mueller*'s understanding of *Smolowe* would apply also to them. Even so, *Mueller*'s admonition to the trier of fact to seek from the evidence, if at all possible, a basis upon which a realistic interpretation of fair market value can be made, is to me a highly responsible mandate.

The Purchase

During the six month period involved in this case there were between 10,363,102 and 10,410,292 shares of Allis' common stock issued and outstanding. G&W opened it by buying 3,000,000 shares through an exchange offer and later acquired directly from the Oppenheimer Fund, Inc., an additional 248,000 shares. Before the end of the period G&W sold all 3,248,000 to a single purchaser, White Consolidated Industries, Inc.

The parties disagree as to the date upon which G&W acquired the 3,000,000 shares, not because it was the day that began the six month countdown, but because of the substantial difference in value of the stock on the different dates asserted by the parties to be the date of purchase. The exchange offer was publicly noticed through the press by G&W on May 7, 1968. There is no evidence as to whether or not there was any awareness of G&W's intentions prior to that date. The offer was to purchase from all Allis shareholders on a pro-rata basis up to 3,000,000 shares, offering in exchange for each share: $11.50 in cash; 9/10 of a warrant to expire January 31, 1978 to acquire a share of G&W common at $55; and a $12.50 principal amount of a 6% G&W Subordinate Debenture to be due July 1, 1988. According to the proxy statement the exchange offer was conditioned on approval of G&W shareholders on July 29, 1968. If this approval were forthcoming, G&W would accept all Allis shares tendered up to 3,000,000. If more than 3,000,000 would have been tendered by July 19, 1968, all would be accepted on a pro-rata basis. If fewer than 3,000,000 would have been tendered by July 19, G&W would accept all shares tendered after that date in their order of receipt up to 3,000,000 shares. All tenders were irrevocable.

Before July 29, 1968, more than 3,000,000 Allis shares had been tendered, and on that date G&W's shareholders approved the Exchange Offer. Thereafter, in the "Initial Statement of Beneficial Ownership of Securities" required by Section 16(a) of the Securities Exchange Act of 1934 to be filed with the SEC, it was stated that G&W acquired 3,000,000 shares of Allis' common on July 31, 1968. In G&W's monthly report to the SEC for the month of July, 1968, it was stated that "Registrant, on July 31, 1968, acquired 3,000,000 shares of common stock of Allis-Chalmers." In a document called "Welcome to Gulf & Western" sent out to the new G&W warrant holders under the exchange offer, it was stated that "The effective date of the Exchange was July 31, 1973." G&W's warrant agent dated all warrants given in exchange for Allis common, on the date July 31, 1968, and an answer by G&W to one of Allis' interrogations filed in these proceedings contained sufficient reference to July 31, 1968, to generate a contention by Allis that G&W judicially admitted July 31st to be the acquisition date; but the certainty of that answer as an admission is clouded by the nature of the answer and the context within which it was given.

Using July 29, 1968 as the valuation date itself, G&W comes out with a gross purchase price per Allis share of $37.93. Using July 31 as a controlling date, Allis comes out with a gross purchase price per Allis share of $35.37. This difference, crudely stated, of $2.56 per share, places the parties initially seven million dollars apart in their computations.

Allis contends that the court is bound by the manner in which G&W handled the exchange offer in its accounting, public and judicial records, and statements. Allis contends that as far as possible the court must resolve issues in favor of the plaintiff, because 16(b) is "remedial". Thus

Allis, by holding G&W to the July 31st date, a day on which the stock market was closed, acquires August 1st as the valuation date, a day which, over July 29th, substantially maximizes profit. On August 1st nothing happened between the parties. On July 29th G&W itself became irrevocably bound to Allis' shareholders who in reliance on the terms of the exchange offer had irrevocably tendered their stock for securities that in turn had a remote equitable interest in Allis. To use estoppel here to argue against a contractually relied upon date as the day for valuation that will "squeeze out" all possible profit is almost to manufacture profit and to render the statute punitive and not remedial.

As indicated above, in 16(b) determinations, the manner in which a corporation handles its financial records and statements for its own or public purposes, and its statements in courts may, like admissions against interest, weigh heavily against such corporation, but the court may not use these facts to abandon its duty of determining the market value. Estoppel will not intervene to bind a party to what otherwise under the facts would be an erroneous determination of artificial profit. *Mueller* v. *Korholz, supra; Park & Tilford, Inc.* v. *Schulte, supra; Champion* v. *Jeffress*, 352 F.Supp. 1081, 1084 (E.D.Mich. 1973).

Earlier in this case, when it was before the District Court for the Eastern District of Wisconsin (the case was later transferred to this district), Judge Reynolds of that court announced that the date of purchase is that on which the "insider" becomes bound and by the act of shareholder approval entitled to acquire the tendered shares. *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Industries, Inc.*, 309 F.Supp. 75, 80-81 (E.D.Wis. 1970). I conclude with him, from all the evidence that July 29, 1968 was for purposes of valuation the date of purchase.

Plaintiff contends that the value of 9/10ths of a G&W warrant expiring in 1978 to acquire a share of G&W's common stock at $55 must be merely 9/10ths of the low at which those warrants were traded on the exchange on the valuation date. When we use the date Allis chose—August 1, 1968—and that day's low—13.875, we come out with a figure of $37,462,500.[3] When we use the date of the rule of this case—July 29, 1968—and that day's low of 15.0, we come out with a figure of $40,500,000.[4] I disagree with both. If an investor is to be ordered to turn over his "profit", without proof of wrongdoing, it should be real and not manufactured profit. The research and reporting services relied upon by the public in the market recite lows and highs to reflect trends, but when reflecting an isolated day in a single figure they use an average. A quick average is half the sum of the high and low. A refined average would be the volume-weighted average for the day. We should use neither the high nor the low if we have the facts from which to make a realistic determination. *Mueller* v. *Korholz, supra; Volk* v. *Zlotoff*, 318 F.Supp. 864, 866 (S.D.N.Y. 1970).

Defendant contends that as to its warrants, we at least should consider their volume-weighted average on July 29th. This average was 15.56301. When we use that average we come out with the figure of $42,020,127.[5] With this I agree. But then, the defendant goes further and urges that a realistic valuation of the warrants would recognize the effect of arbitrage upon the value of the

[3] 9/10ths of 13.875 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 13.875.

[4] 9/10ths of 15.0 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 15.0.

[5] 9/10ths of 15.56301 x 3,000,000; or 9/10ths of 3,000,000 (2,700,000) x 15.56301. Defendant rounded this figure for the average at 15.56, and came out with the lesser amount of 42,012,000.

warrants. This, according to G&W, would require using the weighted-average in the trading of the warrants over the period of May 7, 1968, when public notice was given of the intent to follow through on the exchange offer, and July 29, 1968, the acquisition date. This average was 18.93. Were that average used, we would come out with the figure of $51,120,000; the amount G&W claims to be the proper valuation. With this I do not agree.[6] I am of the opinion that to apply arbitrage would be unrealistic and artificial.

[6] I learn from the witnesses that quite commonly during exchange and tender offers specialized trading comes into play and affects the market price of one or the other of the securities involved, from the time of a market awareness of a proposed exchange or tender offer until the consummation of the transaction.

Generally the proponent of the exchange, the seller, in order to insure the success of his proposal, places in the package he offers as consideration things that would add up to a higher market value than that of the securities sought. This, I am taught by the witnesses, attracts arbitrageurs whose dealing in these securities causes their market prices to be unrepresentative of what they would be even when they reflect the offer. Fair market value thus should reflect an averaging out of the difference between the down pressure of arbitrage activity and the resistance of the security to that pressure.

The defendant strongly urges that statistics show that arbitrage did occur here and that the value of the warrants should take it into account. But the reports of Investment Statistics Laboratory show no changes in the trading and prices of the warrants, at least during the first two months of the exchange offer which could not be attributed to the offer itself. Were arbitrage applicable in this case, it seems to me that to strike an average over the entire period of awareness of the offer when no serious drop in the prices of the warrants occurred until a few weeks before the acquisition date, would give excessive weight to the high as against the low. This indeed would be manufacturing a valuation.

On the other hand, the evidence shows that without any dramatic increase in warrants outstanding from April through July, there was a dramatic increase in short interest over the period of the exchange. The percentage of short interest to outstanding warrants increased from .4 in April to 13.4 in May, and then to 14.7 in June and 18.9 in July. In August it returned to 8.0, in September to 4.5 and in October and November back to .4. When this fact is placed along side the daily trading and closings of the warrants over the same

In 16(b) valuations of the consideration given through exchange offers in payment for the stock of the plaintiff corporations, making adjustments of market value to reflect the impact of arbitrage activities upon securities of one side would deprive the parties of fundamental fairness. G&W would have a windfall of at least $4,981,500.

I find no case law to guide me on this issue, but when I analyse carefully the testimony of the expert witnesses I conclude that in any case in which the purchase is effected through a security for security exchange offer, adjusting the market value of the securities given as consideration for the target securities to reflect the impact upon the market of arbitrage would be improper. To allow G&W an additional cost amount reflecting arbitrage, would be to give G&W compensation for having made the exchange offer.

The effect of the exchange offer itself on the market price, as from day to day while it is open and information and rumors about it change, is as substantial an unknown

period of time, it becomes clear that there was arbitrage relating to this exchange offer. But it becomes equally clear that it had no effect upon the market of the warrants until on or after July 12th on which day they traded dramatically low and closed at 19.25. Prior to then its closings described no pattern. During the 42 market days from May 7 to July 12, the movements were not unusual. There was a lowest closing at 17.25 on June 28th, and a highest closing at 20.75 on July 8th. But after the 19.25 closing of July 12th there was a meaningful, consistent decline to an all time low of 13.875 on August 1st. It is this decline which would reliably reflect the effect of arbitrage activity.

Were I to give a fair value to the impact of arbitrage upon the market price of the warrants on the date of purchase, I would strike an average between the closing on July 12, 1968, as explained above, and the weighted-average of the trading on July 29, 1968. With that in mind, I would find the fair market valuation of the G&W warrants given as part of the consideration for the Allis common at the time of the purchase to be $46,993,500. (Half the sum of 19.25 and 15.56 is 17.405. 9/10ths of 17.405 x 3,000,000 (or 17.405 x 9/10ths of 3,000,000) (2,700,000) comes out to be $46,993,500.)

as is arbitrage. Both are that speculative in nature that when the proponent of an exchange offer, as here, puts together his package of considerations to pay for the target security, as he is deemed to have placed in it what will insure the success of the exchange, so he must be deemed to have withheld from it what he calculates will be necessary to cover for the aberrations of the market, including arbitrage. Were he, hypothetically, buying up his own package at the time of the exchange, and in the market place, and were he allowed an adjustment for arbitrage, he would benefit from it twice. Just as the court will not construct a valuation to manufacture a higher profit, so it will not permit considerations which, though perfectly fair and proper in other valuations, have the effect of manufacturing an undeserved deduction from profit.

In view of the foregoing, I conclude that the value to be assessed the warrants given as part consideration for the 3,000,000 Allis common shares on July 29, 1968, is $42,020,127.

The third item of the consideration given for each of the 3,000,000 shares of Allis' common stock was a $12.50 principle amount of a G&W 6% subordinated debenture.[7] The debentures were issued in denominations of $100 and for each Allis share one eighth of a debenture was given. There thus were 375,000 of such debentures issued and all were given in the 3,000,000 share exchange. They were new debentures due in 1988. On the date of purchase controlling in this case, July 29, 1968, none of these debentures were traded on the stock exchange. As far as that is concerned, even the August 1st date claimed by Allis to be the proper date of purchase would not serve to give a fair market value to them because there were too few traded upon which a

[7] The first item was $11.50 cash per share. 3,000,000 x $11.50 = $34,500,000.

fair valuation could be based. On July 29th there were outstanding and being traded in substantial amounts similar debentures due in 1987. On that day $87,000 of them were traded with an average between the high and low of 80.875.

The new debentures were first admitted to trading on the New York Stock Exchange on August 8, 1968. On that day, 332 one thousand dollar units were traded. They opened at 75, closed at 75, had a high of 76, a low of 74, and a volume-weighted average of 75.15023. Both Allis and G&W refer to August 8th for a meaningful valuation. Allis claims the amount should be the low of $74 because, it asserts, "Section 16(b) case law the lowest price of a security on the date of purchase governs." G&W claims that the amount should be the volume-weighted average of the August 8th trading, $75.15 each. None of the experts were able to place a hypothetical or real valuation on the debentures, either as of July 29th or August 1st, based upon knowledge existing as of that day.

To choose the low of August 8th's trading, as requested by Allis, just to "squeeze out all possible profits", is to manufacture valuation. Since similar debentures were trading with a high-low average of 80.875, and since our debentures themselves finished out the rest of August with an average closing of 76.47, the volume-weighted average of the first trading day, August 8th, $75.15 is quite realistic of what would have been the fair market value on July 29th, had there been a market. Accordingly, I find the value of the debentures given up in the exchange offer to be $28,181,336 ($75.15023 x 375,000).

In addition to the 3,000,000 shares of Allis' common acquired by G&W through the Exchange Offer, G&W later purchased 248,000 shares from Oppenheimer Fund, Inc. Their agreement of August 28, 1968, provided that in

exchange for the Allis stock Oppenheimer Fund, Inc. would receive 496,000 G&W warrants. Because the consummation of this agreement depended upon, among other things, the listing of the G&W warrants and underlying common stock to their respective stock exchanges (subject to official notification of the issuance), the agreement called for a closing date three days after such listing but not later than September 30, 1968; and G&W would receive all dividends paid on the Allis shares after the agreement date, August 28th.

Although the G&W warrants would be listed without SEC registration and thus were not freely tradable, G&W agreed to file a registration on or before April 30, 1969. G&W also agreed that if the registration statement did not become effective by December 31, 1968, and if Oppenheimer chose to sell any warrant in the ninety days following the effective date of registration, G&W would guarantee or pay Oppenheimer an average gross price of $13.50 for each warrant Oppenheimer sold. The agreement was closed on September 30th. G&W did not cause the registration statement for the warrants to become effective until January 13, 1969, thus bringing into effect the agreement's price guarantee. On March 18, 1969, Oppenheimer informed G&W of its sale of 8,500 warrants and its plan to sell the remaining warrants beginning after March 21, 1969. The parties however reached an agreement wherein Oppenheimer would defer the immediate sale of the warrants, and G&W would extend the guarantee until October of 1969. On April 18 Oppenheimer invoked the extended guarantee and a week later made its demand upon G&W for $2,154,450. G&W paid it on June 5, 1969.

The parties have agreed that the valuation date of these 496,000 warrants was September 30, 1968. The agreement is realistic and I approve it. These warrants were un-

registered at the time of purchase and their valuation must reflect that fact. On that date registered warrants were traded on a volume-weighted average at $16.11444. The experts were of the opinion that the discount should be between 9.5% and 18%. One figured the discount to be 9.5%. Another's opinion was 15%. Still another chose generally between 13% and 18%. The 15% was based upon the average of the trading in the warrants on September 30. I find it thus the most realistic discount. This would make the fair value of these warrants, there being no market, $13.69.

Placed upon this discounted price must be a value representing the guarantee to register within 3 months. If the warrants were not registered, as agreed, Oppenheimer could sell at what it could get, and in addition charge back against G&W the guarantee premium up to $13.50 per share. Since the guarantee was a penalty obligation, it seems to me that the guarantee of $13.50 and the discount of $13.69 would cancel each other, and leave the valuation to be attributed to the cost to G&W at the market price of September 30, 1968, less the difference between the discount and the guarantee, i.e., less 19¢. I therefore place on this purchase a price of $7,896,320 ($15.92 x 496,000).

From the foregoing, I find that the total purchase price paid by G&W for its purchase of the Allis common acquired through the exchange offer to be $104,701,463 and the purchase price of the total of the 3,248,000 exchange offer and Oppenheimer shares to be $112,597,783.

The Sale

When G&W on December 6, 1968, sold all 3,248,000 of its Allis common to White Consolidated Industries, Inc., it took in exchange $20,000,000 in cash, White's Promissory Note in the amount of $93,680,000, and 250,000 shares of White's common stock.

Between the parties there is no dispute about the $20,000,000, and little disagreement over the valuation to be given for the 250,000 shares of unregistered White Common Stock. Unlike the unregistered G&W warrants which figured in the contract between G&W and Oppenheimer, wherein a guarantee served to offset the discount, in the receipt by G&W of 250,000 shares of White's unregistered common as part of the sale price of the Allis common stock it had acquired, there was no price guarantee. One of the experts placed the discount at 15.3%, another at from 25% to 30%, and a third at 25%. The first of such expert's testimony was an "Offer of Proof" permitted in evidence, but because of his absence on the witness stand he was not confronted by cross-examination. I agree with the parties that the expert testimony setting the discount at 25% is well documented and convincing. Where the parties differ is whether the discount should be applied to the high of White's common selling on December 6, 1968, or to the volume-weighted average of the stock traded that day. For reasons already I have given and consistent therewith I find that the base figure should be that of the volume-weighted average. On that day there were 111 transactions involving 31,100 shares. The high was 42.50; the low was 39.25. The stock opened at 39.375 and closed at 42.00. The volume-weighted average was 40.6053. I find the fair value to be attributed to the White unregistered common was $7,613,493 ($40.6053 discounted by 25% x 250,000 shares).

The valuation on which the parties differ most dramatically is that to be assigned the largest consideration given G&W by White in its purchase of the 3,248,000 shares of Allis common, White's unsecured, six-month, 8½%

promissory note in the amount of $93,680,000. The note must be valued as of the date it was given, December 6, 1968. The note was paid on March 20, 1969, but on December 6th it was impossible to know whether or not it actually would be paid on or before its due date. 16(b) valuations cannot be determined by hindsight. There are those who say that hindsight can test the accuracy of the earlier determination; but I find this test evidentially incompetent. At most it is a consolation for the one who turned out to have been right, but it can't prove that he was. It is evidence of the nature of the risk inherent in the foresight which is competent to establish the accuracy of the valuation. Of the same non-evidential worthlessness is the fact that after December 6th, G&W twice tried to sell the note and was advised that it could not sell it at anything near par. G&W had accepted the note on December 6th at face value.

Allis further contended that G&W is estopped from claiming any value other than the face amount of $93,680,000 of the note, because of the manner in which in its own and public records it had handled the note. On December 6th, G&W placed the note on its record books kept for internal control at its face amount, in its communications with its stockholders reported the note in its face amount, and did the same thing in its filings with the SEC.

Allis further argues that as a matter of law the intent of the parties to the note as expressed in their contract, which recited the note at its face value, controls valuation as it shall be determined by this Court. As authority for this position Allis cites *Kern County, supra, Bershad* v. *McDonough*, 428 F.2d 693, 698 (7th Cir. 1970), and *Newmark* v. *RKO General. Inc.*, 425 F.2d 348, 357 n.9 (2nd Cir. 1970); and states that such an approach is entirely

consistent with the statutory purpose of squeezing all of the profit out of a short-swing purchase and sale that violates 16(b).

I find that none of the cases cited by Allis in aid of its position on this matter supports it. I already have found that, though a party's handling of valuations in its private and public representations may serve as admissions against interest, estoppel will not serve to relieve the court of its duty to determine a realistic market value.

G&W argues that the note was "commercial paper" as differing from "investment paper", the former marketable only at a discount. It is apparent that because the short life and the size of the note on the one hand, and the nature of its promissor and the size of its interest (two points above the prime bank rate at the time), the note was of a hybrid nature that kept it from fitting comfortably into either of these categories. It seems to me that the disinterested but available third party investor would consider the note as worth something less than face value but certainly not as conventionally discountable "commercial paper". It seems to me, considering a comprehensive evaluation of the opinions of the experts who testified about it, he would, in purchasing it, lower it by some broker-like or cost for placement coefficient of risk below its face value. I am convinced that such adjustment would be closer to half the lowest suggested 10% discount attributed to it as commercial paper.

I was particularly impressed with the testimony of two experts, one a Kenneth V. Zweiner, and the other a Lewis Glucksman. Mr. Zweiner considered the note as "money good", and as a banker, had he been approached on December 6th, would have participated with other banks in purchasing the note at face value. Mr. Glucksman, head of the corporate bond department of Lehman Brothers

which had handled commercial paper in excess of 40 billion dollars during last year, had at the time in question advised G&W that the note was "non financible" and that it would have to be factored at 10% to 15% less than its face amount. During this time Glucksman had personally reviewed White's financial condition and found it "unhealthy".

Mr. Zweiner considered that White had a substantial cash throw off in excess of forty million; that White had a good current ratio (excess of current assets over current liabilities) although it had a heavy debt structure; and that White had a good equity base behind it. Mr. Glucksman considered the note as an "unusual" one and too big for Lehman Bros. There had been telephonic commitments of banks to share in picking up the note (prior to December 6th) up to 50 millions of its face, but these commitments were qualified in that additional banks would have to be retained to handle the balance. The lending market at that particular time was tight; but that meant even the more that institutional type investors furnished an available market for long term interest-bearing secure investments. The excellent testimony of all of the many expert witnesses concerning this note considered comprehensively as stated above, causes me to find the market value of the note on December 6, 1968 to have been 5% off its face value, i.e., $88,990,000.

It follows from all the above that the market value of the total consideration G&W received in exchange for its 3,248,000 shares of Allis' common stock it sold on December 6, 1968 to White Consolidated Industries, Inc. is $116,-609,493.

Costs, Dividends and Interest

Certain collateral matters must be considered which bear upon the question of the amount of profit which the defendant, G&W, must turn over to the plaintiff, Allis: (1) allowable costs incurred in connection with the acquisition and disposition of the 3,248,000 shares of Allis' common stock within the statutory period; (2) the dividends paid by Allis while its stock was being held by G&W; and (3) interest on the profit.

As to the first of these items, the parties have stipulated that G&W's expenses incurred in connection with its exchange offer were $2,874,175.67, and in connection with its acquisition of the 248,000 shares acquired from Oppenheimer were $1,696.33. No evidence was presented regarding these matters other than the stipulation of the parties. In light of all the evidence, I find no reason to question these amounts of expenses presented me by the agreement of the parties. The total of expenses incurred then is $2,875,872.

As plaintiff admits, case law supports the proposition that the expenses of a defendant in performing a purchase or sale are a deduction from profit in 16(b) cases. *Blau* v. *Mission Corp.*, 212 F.2d 77, 81 (2nd Cir. 1954); *Arkansas Louisiana Gas Co.* v. *W. R. Stephens Invest. Co.*, 141 F. Supp. 841, 845, 847 (W.D. Ark. 1956).

The second of these matters arises from Allis' claim that there should be included in G&W's profit the $406,000 dividends which Allis paid on the 3,248,000 shares of common stock while they were in the hands of G&W during the statutory period. Plaintiff relies for this contention on *Western Auto Supply Co.* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736, 744 (8th Cir. 1965), cert. denied 382 U.S. 987, and assumes support for its position in several other cases. I find it difficult to distinguish our case from *Western Auto*

on the facts in order that its rule of law not be dealt with. In neither case was the purpose of the short-swing purchase and sale the making of a special profit from the dividends. If it has a legal message to be followed it is that there is no question about the fact that dividends should be available to the court to be used in situations where the conduct of the defendant was reprehensible—where the acquisition of substantial stock in a company was for the purpose of maneuvering the payment of large dividends—where the dividend itself was the target of stock manipulation.

Courts often have permitted the recovery of dividends when it could be inferred that there was some intended connection between the dividends and the short-swing transaction. *Blau* v. *Lamb*, 363 F.2d 507, 528 (2nd Cir. 1966); *Adler* v. *Klawans*, 267 F.2d 840, 848 (2nd Cir. 1959); *Marquette Cement* v. *Andreas*, 239 F.Supp. 962, 968 (S.D. N.Y. 1965). But any use of *Western Auto* to go beyond this approach is to take a backward step from those cases. I find *Western Auto* now to be of dubious precedential vitality. Its holding was reached without any apparent analysis of any special role which dividends played in the case; and gracefully it was retreated from by the same court three years later in *Petteys* v. *Butler*, 367 F.2d 528, 535 (8th Cir. 1966), cert. denied 385 U.S. 1006 (1967).

Experts in the field look upon anticipated dividends as part of the package for which the consideration is paid when the stock is purchased. In addition, dividends are not an element of profit in the sense that they do not result from the purchase and sale of stock, but rather come from the holding of stock. See 45 Va. L.Rev. 1057, 1060 (1959). In the language of the statute dividends logically are not profit. The statute reaches "*profit realized from the purchase and sale*". Dividends thus are treated by the statute like an operational earning or income. This statutory interpretation reads upon the ordinary thinking about dividends in the market place. Except where they are a matter of special concern, the market price generally is presumed to cover dividends reasonably anticipated. At least to the extent that they regularly are paid, they are considered absorbed in the price paid for the stock.

To permit recovery by Allis of the 12½ cent quarterly dividend involved here would be unconscionable for a further reason. The evidence shows that Allis, in its fighting back at G&W's attempt to gain control of it, on August 9, 1968, nine days after the exchange offer was confirmed, slashed its regular and historic 25¢ quarterly dividend in half. The prospectus on the exchange offer, in reciting the dividend history of Allis, mentioned that in each of the first two quarters of 1968 a cash dividend of 25¢ per share had been declared. Moody's Dividend Record showed a continuous dividend record of 25¢ per quarter from and including the fourth quarter of 1966. It is retributive for Allis to say to G&W, "When we found that you had succeeded in acquiring one third of our stock through your exchange offer, before you could exercise a voice in our control we slashed our dividend in half. This should discourage you from any further attempts to divest us of our management controlled independence. But when you sold short of the statutory six months and made available to us the use of Section 16(b) to squeeze out of you every penny's profit, you gave us the right to get back as a part of 'profit' even the half dividend we paid you." For the Court to join Allis in this retributive approach would be for the Court itself to offend traditional notions of fair play and substantial justice.

Of the same vein must be this Court's response to plaintiff's demand for interest on the amount of the profit from the date of the sale to the time of this decision. If interest

is added it certainly should not continue to the time of decision. This causes the total amount of interest to be measured by periods of time not within the control of the parties. These would vary from court to court, reflecting the different programs of courts in the management of the flow of cases through them. Not even should attorneys feel responsible for increases or reductions of potential awards to their clients because of the necessity for the flow of cases also to reflect necessary adjustments of time to accommodate reasonable uncertainties in professional availability. Litigants themselves should not be discouraged from participating fully in statutorily granted causes of action, either as plaintiffs or defendants, by knowledge that the size of awards will be materially affected by the professional affairs of lawyers and courts.

I am of the further opinion that the concept of interest in 16(b) cases offends logic. Since interest represents "the wages of money (or money measured values) at work", it ought be treated as such. If one wrongfully is deprived of the use of money in which one has a proprietary right, the wrongdoer should return it together with the wages it reasonably could have earned throughout the period its owner could have put it to work. The purchaser of stock of a corporation, issued and outstanding, is not taking from the corporation itself values which the corporation could itself have put to work. It is conceivable that the diving in and out by a short-swing profiteer can injure the corporation. I find no support for the idea that relating the profit to the injury would be measuring comparables. A corporation's relationship to its issued and outstanding stock is fiduciary. When a stockholder transfers his stock to another, the corporation's relationship remains intact. The corporation itself has been deprived of nothing. It is my opinion that Congress in §16(b) did not create in the corporation a new

proprietary right in the stock, as against a stockholder or his successor, whether or not he is a "statutory insider". It created a bounty-like award for the target corporation which, like a public prosecutor, succeeds in bringing the one who violates the statute to answer for his wrongdoing. Its award attaches when it has succeeded. Interest, if any, should attach when and if this judgment order is entered in the plaintiff's favor and against the defendant.

Whether or not this logic is correct and controlling, prejudgment interest should not be awarded, in light of case law. Cases permit interest as a matter to be determined by the Court in exercise of equity only if the defendant's conduct has been reprehensible. The last case on the matter of 16(b) interest today is *Gold* v. *Sloan*, 486 F.2d 300, 353 (4th Cir. 1973).

In *Gold* v. *Sloan* both the majority opinion and the dissent agreed on the issue of interest. They observed that the trial court had allowed interest as a matter of course. The trial court's order had simply said that "interest on the amount of profit is a proper item of damage". Relying upon *Blau* v. *Lehman*, 368 U.S. 403, 414 (1962), the Fourth Circuit stated that:

> "The governing rule is that '* * * interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness * * *'. This rule has been followed in recent cases where interest was not awarded upon the showing of 'good faith' on the part of the defendant. Blau v. Lamb (D.C.N.Y., 1965) 242 F.Supp. 151, 161; Volk v. Zlotoff (D.C. N.Y., 1970) 318 F.Supp. 864, 867; Lewis v. Wells (D.C.N.Y., 1971) 325 F.Supp. 382, 387."

The Fourth Circuit said interest would be inequitable because it found in *Sloan* an absence of willfulness in the violation and an unavoidably lengthy proceedings. The Supreme Court in *Blau* v. *Lehman, supra,* ruled by analogy and set by its language the reasoning used by the Fourth Circuit.

For the same reasons, which I here adopt, as well as for the reasons I advance above, I hold that interest is not allowable in this case. Here there has been no showing of wrongdoing by the defendant.

It then appears that only one of these three collateral matters may figure into the profit. It is the expense amount of $2,875,872 incurred in the acquisition of Allis stock. This then would add to the purchase valuations before they are deducted from what is calculated to be the valuation assessed the sale to White Industries.

Recapitulation and Conclusion

To recapitulate, I have found the sale valuations to total $116,609,493. This is made up of the $20,000,000 received in cash by G&W, the $7,613,493 value of the unregistered White common stock received, and the $88,996,000 valuation of the $93,680,000 White Promissory Note accepted by G&W. I have found the purchase valuations to total $115,473,655, which amount includes the $2,875,872 stipulated with approval of the Court to represent the cost to G&W of engaging in its exchange offer and other negotiations. The total not including the costs, $112,597,783 is made up of three figures: the $34,500,000 cash given as part payment for the exchange offer purchase of the 3,000,000 shares of Allis' common stock, the $42,020,127 valuation placed upon the G&W warrants which went into the exchange offer, the $28,181,336 valuation placed upon the G&W debentures

which also were part of the exchange offer, and the $7,896,320 valuation placed upon the acquisition by G&W of the 248,000 shares of Allis stock acquired from the Oppenheimer Fund. The differences leave a profit by G&W to be accounted for to Allis in the amount of $1,135,838. This Court boasts no competency at simple mathematical computations, wherefore, subject to traditional re-examination of the arithmetic involved, it respectfully addresses to the parties this final determination.

In conclusion, the approach of the Court to this cause has been with an awareness that the corporate form of business enterprise increasingly serves the welfare of our modern society, but that the vitality and the integrity of that form must be protected against its use as a shield for wrongdoing. The statute called upon in this case is by legislative action an attempt on behalf of that society to provide by law that protection. It is an effort to monitor the conduct of those in positions of special knowledge of or control over a corporation's affairs. The business world has long been concerned about the statute itself. Some consider it too loose in its terms because it leaves too broad an area in which the courts may determine its proscriptions. Others also desire its repeal or revision because they consider it too severe. The SEC regards its administration a matter for the courts. Congress left its enforcement to corporate investors and provided therefor the exclusive jurisdiction of the federal courts and their traditional powers in equity. The courts in turn faithfully have sought to maintain the Congressional purpose without abandoning their basic principles of justice and fundamental fairness.

It has been held by the Court that in assessing profit, if any, it must make determinations of valuations as of the time of purchase and sale and in terms of fair market value (or fair value in the absence of market), and that such

valuations must be realistic—not artificial. It has been determined that in 16(b) purchases by exchange offers it would be unfair to take into consideration the fact of arbitrage; and that dividends and interest are improper considerations, but that if a defendant's conduct has been reprehensible, they are available to the Court for consideration to the end that the result be effectively remedial (never punitive).

In conclusion, it has been determined that the defendant, Gulf & Western, considering the size of its purchase, and the facts of its purchase and sale, became a statutory insider, and liable to turn over to the plaintiff its profit from the purchase and sale; but that it did nothing wrong, as far as speculative abuses are concerned. It has been found that judgment should be entered against the defendant, Gulf & Western, and in favor of the plaintiff, Allis-Chalmers, in the amount of $1,135,838.

Accordingly, it is so ordered, adjudged, and decreed.

This Memorandum Opinion and Order shall constitute my findings of fact and conclusions of law.

ENTER:

/s/ JAMES B. PARSONS
James B. Parsons
United States District Judge

Date: January 30, 1974
Date of Revision: March 4, 1974

APPENDIX C

IN THE

Supreme Court of the United States

OCTOBER TERM 1974

No. 74-742

FOREMOST-MCKESSON, INC.,
Petitioner,

v.

PROVIDENT SECURITIES COMPANY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MOTION OF ALLIS-CHALMERS MANUFACTURING COMPANY FOR LEAVE TO FILE THE ACCOMPANYING BRIEF AS AMICUS CURIAE IN SUPPORT OF THE POSITION OF THE PETITIONER

Allis-Chalmers Manufacturing Company ("Allis") hereby respectfully moves the Court for leave to file the accompanying brief *amicus curiae*. Attorneys for respondent have indicated that they consent to the motion. The consent of the attorneys for the petitioner in whose behalf this brief is submitted, was refused.

THE DECISION BELOW

The opinion of the Court of Appeals is reported at 506 F. 2d 601 (9th Cir. 1974). The opinion of the District Court is reported at 331 F. Supp. 787 (N.D. Cal. 1971).

The Court of Appeals held that § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (the "1934 Act") did not apply to a purchase and sale of more than 10% of a class of equity securities of Foremost-McKesson, Inc. ("Foremost") which occurred within a period of less than six months, because Provident Securities Company

("Provident") had not been a 10% owner of such securities prior to its purchase. According to the Court, Provident was exempted from § 16(b) liability because it was not the beneficial owner of 10% of the shares of Foremost "both at the time of the purchase and sale."

THE INTEREST OF ALLIS-CHALMERS MANUFACTURING COMPANY

The interest of Allis arises from the fact that it is the plaintiff-appellant in an action currently pending in the United States Court of Appeals for the Seventh Circuit, entitled *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Ind., Inc.*, Nos. 74-1266 and 74-1267 (7th Cir., filed Feb. 12, 1974). In that action the District Court held that Gulf & Western Industries, Inc. ("G&W") had violated § 16(b) of the 1934 Act by reason of the voluntary purchase of 3,000,000 shares or approximately 29% of Allis' common stock in July, 1968 and the sale, less than six months thereafter on December 6, 1968, of that block together with an additional 248,000 shares purchased in September, 1968. Prior to its initial purchase of 3,000,000 shares of Allis' common stock in July, 1968, G&W had not owned any equity securities of Allis.

The question presented in the *Allis-Chalmers* and *Provident* cases is whether a purchaser of securities registered under the 1934 Act becomes subject to § 16(b) at the time he acquires that very interest which makes him a 10% shareholder, or only as to subsequent purchases followed by sales within six months.

QUESTIONS THAT MAY NOT ADEQUATELY BE PRESENTED BY THE PARTIES

In the instant case the respondent Provident was a personal holding company which determined in 1969 to liquidate and dissolve. Although Provident desired to have liquid assets to distribute, when it entered into an agreement with Foremost, Foremost required as a condition to

purchasing two-thirds of Provident's assets that Provident accept in part payment, Foremost convertible debentures to be issued for that purpose. Although Provident preferred to sell its assets for cash alone, "eventually it compromised and accepted convertible debentures, one half of which would be registered as soon as possible after closing so that the stock could be offered to the public." (506 F. 2d at 603).

Pursuant to the purchase agreement, Foremost delivered to Provident at the closing on October 15, 1969, $4,250,000 in cash and a Foremost debenture in the principal amount of $40,000,000 which was immediately convertible into common shares comprising more than 10% of Foremost's common stock. This debenture was subsequently split into two debentures in the principal amounts of $25,000,000 and $15,000,000. At the same time Foremost delivered a $2,500,000 debenture to an escrow agent on Provident's behalf. On October 20, 1969 Provident received an additional debenture in the principal amount of $7,250,000.

To accomplish its purpose of liquidation, on October 21, 1969, Provident entered into an underwriting agreement providing for the sale by it of the $25,000,000 principal amount of debentures it had received. On October 24, 1969, Provident distributed to its shareholders those debentures not commited under the underwriting agreement and ceased to be a 10% shareholder. On October 28, 1969, at the closing under the underwriting agreement, Provident received a check for $25,366,666.66 from the underwriters and in return delivered to them the $25,000,000 debenture (506 F. 2d at 603-04).

It was against this background of Foremost's insistence upon the form which this transaction assumed that the District Court, applying principles of equitable estoppel, said:

"In all its essential details the form of the transaction was insisted upon if not dictated by Foremost, often contrary to the plans and wishes of Provident. If the matter had been handled as Provident wished, this case could never have arisen. To allow Foremost under these circumstances to recover the small profit of Provident (almost miniscule in terms of the total amounts involved) simply by a mindlessly literal application of Section 16(b) would be to perpetuate rather than correct an inequity. This the Court is unwilling to do." 331 F. Supp. 787, 792.

We do not quarrel with the opinion of the District Court, but wish to point out that the *Allis* case presents an altogether different picture, and one in which all of the equities, unlike the *Provident* case, are on the side of the issuer (Allis), whose shares were the subject of the short-swing trading. In the *Allis* case, G&W, a major conglomerate corporation, voluntarily and in furtherance of its own plans and pursuits, purchased 3,000,000 shares or over 29% of a publicly traded security (the common stock of Allis) and four and one-half months later voluntarily sold it along with 248,000 additional shares acquired after the initial purchase.

In January, 1969, Allis commenced suit under § 16(b) to recover the profits realized by G&W as a result of its short-swing trading in Allis shares. After trial without a jury the District Court found that G&W, following its initial purchase of 3,000,000 Allis shares, was in a position to obtain inside information "had it wanted to." *Allis-Chalmers Mfg. Co.* v. *Gulf & Western Ind., Inc.*, 372 F. Supp. 570, 579 (N.D. Ill. 1974). It went on to hold that when G&W sold those shares within six months it violated Section 16(b) of the 1934 Act, and was required to account for the profits realized. *Id.* at 591.*

* Allis appealed from the District Court's determination of the amount of profits realized by G&W. G&W cross-appealed with respect to the issues of both liability and profits.

It is Allis' position that the voluntary purchases and sale of publicly traded securities involved in its case are far more common and likely to recur than the highly unusual set of transactions involved in *Provident*. It is also Allis' position that the very situation involved in its case, the voluntary purchase of a large block of securities followed by access to inside information and a sale thereof within a six month period, was precisely the situation intended to be covered by § 16(b). As a consequence, Allis is concerned that the important issue involved in the *Provident* case *not* be analyzed solely within its unusual factual context, but only after full consideration of its effect on the more typical fact pattern which the *Allis* case presents.

Therefore, we respectfully urge that Allis' motion be granted so that this Court will have before it the totally different factual situation presented in that case which will be affected profoundly by the result in *Provident*.

April 18, 1975

Respectfully submitted,

S. Hazard Gillespie
Counsel for Allis-Chalmers Manufacturing Company
1 Chase Manhattan Plaza
New York, New York 10005
Tel. No. (212) HA 2-3400

BRIEF IN SUPPORT OF THE POSITION OF THE PETITIONER

JURISDICTION

The judgment of the Court of Appeals was entered on September 19, 1974. The petition for a writ of certiorari was filed on December 16, 1974 and was granted on February 18, 1975.* The jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether the purchaser in a single transaction of more than 10% of the equity securities of an issuer, who theretofore has owned none of said securities but within six months sells the entire block, is liable under § 16(b) of the 1934 Act to return to the issuer any short-swing profits realized?

STATEMENT

We accept and will not repeat the statements of the case as set forth by both the petitioner and respondent in their briefs filed in connection with the petition for writ of certiorari.

STATUTE INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78p(b) (the "1934 Act"), provides in pertinent part:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and pur-

* We understand from counsel for Provident that in their brief they intend to take the position, as they did before the District Court and Ninth Circuit, that § 16(b) is inapplicable to the transaction at issue because the transactions involved were without potential for speculative abuse. *See Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582 (1973).

> chase, of any equity security of such issuer (other than an exempted security) within any period of less than six months,*** shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

ARGUMENT

I

The Cases And Policy Of § 16(b) Require That The Words "At The Time Of" Be Construed To Cover The Initial Transaction By Which A Shareholder Aquires His 10% Interest

The opinion of the Ninth Circuit in the *Provident* case accords with no other Circuit or District Court* which

* *Arkansas-Louisiana Gas Co.* v. *W.R. Stephens Inv. Co.*, 141 F. Supp. 841 (W.D. Ark. 1956), is the lone District Court case which supports the result of the Ninth Circuit. It has been overruled, *sub silentio*, by *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F. 2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972).

has been faced with the precise issue of the applicability of § 16(b) to an initial purchase by which the purchaser becomes a more than 10% beneficial owner of securities followed by a sale within less than six months. *See, e.g., Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918, 922-24 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972); *Perine* v. *William Norton & Co.*, 509 F.2d 114, 118 (2d Cir. 1974); *Newmark* v. *RKO General, Inc.*, 425 F.2d 348, 355-56 (2d Cir.), *cert. denied*, 400 U.S. 854 (1970); *Stella* v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957 (S.D.N.Y. 1952), *aff'd in part, remanded in part on other grounds*, 232 F.2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956).

Moreover, this Court itself has indicated in its most recent decision involving § 16(b), *Kern County Land Co.* v. *Occidental Petroleum Corp.*, 411 U.S. 582, 584 (1973), that

> "Unquestionably, one or more statutory purchases occur when one company, seeking to gain control of another, acquires more than 10% of the stock of the latter through a tender offer made to its shareholders."

and that

> "By May 10, 1967 Occidental had acquired more than 10% of the outstanding shares of Old Kern. It was thus a statutory insider when, on May 11, it extended its tender offer to include another 500,000 shares." *Id.* at 598.

Without question, it would not have been necessary for this Court to reach the issue as it did in that case of whether Occidental had made a "sale" for purposes of § 16(b) had it not first determined that in acquiring its initial more than 10% interest in Old Kern, it had made a § 16(b) "purchase".

Most importantly, the result in *Provident* is directly contrary to the Congressional purpose and the policy of § 16(b) of preventing the possibility of abuse of inside information which may be obtained by a class of insiders solely as a result of its relationship to the issuer. Further it impairs severely the protections § 16(b) provides the investing public by supplying an easy mode of evasion and insulation from liability for large shareholders such as G&W who have the requisite access to confidential information solely by virtue of their large stock holdings. *See, e.g.*, 2 L. Loss, SECURITIES REGULATION 1060 (2d ed. 1961) (". . . it is difficult to quarrel with the [Second Circuit's] preference for the construction which would serve to effectuate the legislative purpose and still leave some meaning for the statutory language when there is an ambiguity . . .") and Cook & Feldman, *Insider Trading Under the Securities Act*, 66 Harv. L. Rev. 612, 631-32 (1953).

In the recent case of *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972), Emerson purchased 13.2% of the outstanding common stock of Dodge Manufacturing Corporation on June 16, 1967. It owned no stock of Dodge at the time of this single purchase. Dodge thereupon arranged a defensive merger with Reliance. Emerson, faced with the prospect of a forced exchange of its Dodge shares for stock in the merged corporation, took steps to mitigate its § 16(b) liability by selling, on August 28, 1967, 37,000 shares—or 3.24%—of the outstanding stock of Dodge, thereby reducing its holdings to 9.96% of the outstanding stock.

In determining whether the purchase by which Emerson became a more than 10% shareholder subjected it to § 16(b), the Eighth Circuit held:

> ". . . we have concluded that the purchase by which a security holder acquires a more than 10 percentum status is included as a part of a pair of transactions of purchase and sale occurring within six months of each other within the meaning of Section 16(b). Any other view has the weakness of impracticability of application of the statute, a result we should not lightly attribute to a Congress striving to prevent what it considered to be highly undesirable speculations by certain security owners who are in position to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." 434 F.2d at 924.

The issue of whether Emerson's purchase of 13.2% of the outstanding stock of Dodge—at a time when Emerson did not own any Dodge stock—brought Emerson within the reach of § 16(b) was not before this Court on appeal and this Court expressly declined to decide it. However, with regard to Emerson's step sales, this Court held that the language of § 16(b) "at the time of the purchase and sale" meant exactly that and thus the second sale, effected while the defendant was the holder of less than 10% of the issuer's stock, was not intended to be covered by § 16(b).

In approving the technique of the step sale transaction by a beneficial owner of more than 10% of the outstanding stock of a company, this Court indicated that the Statute does not foreclose the possibility of the mitigation of damages by step sales. Similarly, it can be said that the exemption "both at the time of the purchase and sale," requires no different interpretation with respect to "stepped up" purchases of the stock of an issuer . Thus for example the purchaser of 9% of the securities of an issuer who shortly thereafter makes a second purchase of an additional 2% or

3% of those securities becomes subject to § 16(b) only on the occasion of the second purchase.* Here G&W in acquiring and disposing of more than 29% of the shares of Allis in one purchase and one sale is not entitled to an exemption for either a "stepped up" purchase or a "stepped down" sale. G&W's conduct was precisely the kind of conduct that § 16(b) prohibits.

Stella v. *Graham-Paige Motors Corp.*, 104 F. Supp. 957, *aff'd in part, remanded in part*, 232 F. 2d 299 (2d Cir.), *cert. denied*, 352 U.S. 831 (1956), was the first case in which a court was required to grapple with the meaning of the "at the time of the purchase and sale" language of § 16(b). In that case, Graham-Paige, the owner of 6¼% of the outstanding shares of Kaiser-Frazer Corporation, purchased in a single transaction a sufficient number of shares to increase its holdings to 21% of all the outstanding stock. Less than six months later, Graham-Paige sold part of its holdings, and suit was brought to recover profits under § 16(b) of the 1934 Act. On its motion for summary judgment, Graham-Paige contended

---

* This Court in *Emerson,* 404 U.S. at 423 n. 3 cites with approval 2 L. Loss, SECURITIES REGULATION 1060 (2d ed., 1961) with respect to step sales. The full text covers both step purchases and step sales.

> "A substantial 'out' nevertheless remains for the 10 percent holder: If a person who is not an insider wants to acquire up to, say, 15 percent, he should buy up to just under 10 percent in one transaction (which will be exempted even under the court's construction [in *Stella* v. *Graham-Paige Motors Corp., infra*]) and then buy the remaining 5-plus percent in a separate transaction. Conversely, a person who owns 15 percent and wants to sell down to 5 percent should sell 5-plus percent in one transaction and then, after he becomes a holder of slightly less than 10 percent, sell out the remainder."

that the purchase and sale involved in the action were exempt from § 16(b) because it was not the beneficial owner of more than 10% of the Kaiser-Frazer stock both at the time of the purchase and sale.

The Court determined that the Congressional purpose underlying the enactment of § 16(b) was clear. Congress intended to protect outside stockholders against short-swing speculation by insiders with advance information and thus:

> "If the construction urged by defendant is placed upon the exemption provision, it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum. A construction such as this would provide a way for the evasion of § 16(b) by principal stockholders, and render it largely ineffective to prevent some of the financial evils which led to the passage of this legislation by Congress." 104 F. Supp. at 959.*

The Court then held that if the words of § 16(b) "at the time" were construed to mean "simultaneously with" rather than "prior to" the purchase by means of which a shareholder becomes 10% beneficial owner,

> ". . . a shareholder would become subject to the provisions of § 16(b) as soon as his ownership exceeded 10% of the outstanding shares. This construction would be consistent with the declared purpose of the statute to prevent the unfair use of inside information by officers, directors, or stockholders owning more than 10% of the equity stock." 104 F. Supp. at 960.

* The Ninth Circuit attempts to resolve this problem by claiming that § 16(b) would be applicable to an initial 10% or better purchase if such purchase is in effect a "repurchase" 506 F. 2d at 614-15. It is submitted that the framers of § 16(b) had no intention of establishing two separate and inconsistent applications for the Statute. Further, such an interpretation conflicts with the objective approach to the meaning of the language of § 16(b) taken by this Court in *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972).

It is Allis' position that the statutory language and the remedial purpose sought to be achieved by the enactment of § 16(b) support the contention that the statute is applicable simultaneously with the purchase by which one becomes a more than 10% beneficial owner of an issuer's securities. We submit that for this Court to affirm the *Provident* case would be to erase much of the protection now offered the investing public by § 16(b). The view of § 16(b) espoused by the Ninth Circuit would permit untrammeled speculation by large security owners who are in a position

> ". . . to obtain or to be exposed to that kind of inside information lending itself to speculative use to the possible detriment of the public." *Emerson Electric Co.* v. *Reliance Electric Co.*, 434 F.2d 918, 924 (8th Cir. 1970), *aff'd on other grounds*, 404 U.S. 418 (1972).

We urge that such a position not be adopted by this Court.

II

The Legislative History Of § 16(b) Relied Upon By The Ninth Circuit In Its Opinion Cannot Withstand Close Scrutiny

In its opinion, the Court of Appeals for the Ninth Circuit extracts from the legislative history of § 16(b) evidence of a non-existent Congressional intent.* To reach this result, the Court relies on the testimony offered in

* It should be noted that this Court determined that "the legislative history affords no explanation of the purpose of the proviso". *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418, 424 (1972).

hearings held only in connection with the following version of § 16(b):

> "(b) It shall be unlawful for any director, officer or owner of securities, owning as of record and/or beneficially more than 5 per centum of any class of stock of any issuer, any security of which is registered on a national securities exchange—
>
> (1) To purchase any such registered security with the intention or expectation of selling the same security within six months; and any profit made by such person on any transaction in such a registered security extending over a period of less than six months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding six months." S.2693 (H.R. 7852), 73d Cong., 2d Sess. (1934).

On the basis of this single draft, the Ninth Circuit concludes that § 16(b) was

> ". . . originally designed to deter insiders from purchasing stock without any intention of making a long-term investment, but only with the intention of profiting from upward fluctuations in the market price that were predictable on the basis of inside information. The section was directed against an insider who has no intention of changing his investment relationship to the corporation, but rather has an 'intention or expectation' to purchase and sell the stock within six months. After the pair of transactions is completed he intends to own exactly the same interests in the corporation as he owned before he began his speculative venture." (506 F. 2d at 609)

The Ninth Circuit, however, has neglected a vital fact in its analysis of the legislative history of § 16(b). The language upon which the Court predicates its conclusion is

drawn from a Senate bill (S. 2693) which never became law—a bill which in fact never received a single vote on the floor of either house of Congress. The present language of § 16(b) can be traced to a different bill (H. R. 8720), which was introduced in the House of Representatives almost a month *after* the hearings quoted and erroneously relied upon by the Ninth Circuit. The new bill reflected several major changes from the prior version, but most important for our purposes, was its elimination of the language that would have tended to limit its application to transactions involving shareholders with pre-existing 10% holdings.

The legislative history gives no indication whatsoever of the reason for deletion of the language relied on by the Ninth Circuit. That Court speculates that this change was made to "ameliorate this difficulty of *proving* intention or expectation" (506 F. 2d at 611; emphasis added), but not to "alter the section's goal of deterring insiders from speculating on the basis of inside information obtained because of 'substantial stockholdings' ". (506 F. 2d at 610).

This explanation, however, is unsatisfactory. It is clear from a review of all of the draft proposals for § 16(b) (see S.2693, H.R. 7852, H.R.8720, S.3420 and H.R. 9323, 73d Cong., 2d Sess. (1934), that *all* were intended to create an irrebuttable presumption of intent, to be inferred solely from the fact of a short-swing purchase and sale. *See, e.g.*, Hearings on S. Res. 84, S. Res. 56 and S. Res. 97 Before the Sen Comm. on Banking and Currency, 73d Cong., 2d Sess., pt. 15, at 6554 (1934) (hereinafter 1934 *Hearings*). Thus, the deletion of the "intention or expectation" language had no effect on the burden of proof.

Still less satisfactory is the Ninth Circuit's curious assumption that by eliminating language which would have

limited the scope of the new law, Congress intended to preserve precisely that limitation. The logical inference is quite the contrary—that Congress intended to *broaden* the bill. Such an extension would be consistent with the contemporaneous change to proscribe sales followed by short-swing purchases as well as purchases followed by short-swing sales.

In view of Congress' silence on this point, the only thing that can be said with any real certainty is the language upon which the Ninth Circuit premises its reading of Congressional intent was deleted in its entirety from the bill *before* passage by either House, and cannot by its absence limit the intended scope of the bill that *was* passed.

Clearer evidence that Congress *did* intend to bring within the ambit of § 16(b) shareholders who acquire their 10% interests *without* having had a prior relationship to the issuer, can be found in the concern expressed during the hearings on the House draft (which is substantially similar to the version of § 16(b) which was enacted) that the section:

> ". . . might prevent arbitrage transactions, because it is very common, in arbitrage, for a man to buy one security and at the same time sell against it an equivalent security. While that process of the arbitrage is going on he might conceivably accumulate more than 5 percent of this security, and he would, of course, be the beneficial owner of that 5 percent. He would, of course, have offsetting contracts or obligations against it, but they are not reflected in the definition which imposes penalties on a stockholder owning 5 percent or more of a registered security." 1934 *Hearings* at 7567 (Statement of Roland L. Redmond, Attorney for the New York Stock Exchange, on S. 8720).*

* The bill as enacted increased the requisite holding from 5% to 10% of the issuer's equity securities.

At the hearing, it was suggested to the Congress that the above problem (which would not arise if the position of the Ninth Circuit were correct) could be remedied by providing at the foot of the bill a provision enabling the commission charged with enforcing it to exempt arbitrage transactions from the force of the Section (1934 *Hearings* at 7567). However, Section 16(e), included in the text of the bill itself, provided *precisely* such an exemption. Moreover, § 16(d) expressly exempted from § 16(b):

> "any purchase and sale, or sale and purchase, . . . of an equity security *not then or theretofore held by him in an investment account*, by a dealer in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market . . . for such security". (emphasis added).

Both of these express provisions are strong evidence that Congress intended to cover by § 16(b) that very transaction making a stockholder a 10% stockholder, for if Congress' thought otherwise, neither exemption would have been necessary.

Another provision suggested by witnesses at the hearings, that the administrative body charged with enforcement be empowered to exempt certain transactions, is included in the text of § 16(b) itself:

> "This subsection shall not be construed to cover . . . any transactions which the Commission by rules and regulations, may exempt as not comprehended within the purpose of this subsection."

Pursuant to this authority, the SEC has by Rule 16b-2 (17 C.F.R. § 240.16b-2) exempted from the embrace of § 16(b) certain transactions engaged in by underwriters. Clearly no such rule would have been necessary if the Section means what the Ninth Circuit has held it to

mean. Moreover, the existence of such a rule is strong evidence that the SEC interpreted § 16(b) as otherwise applicable to such a transaction. See *Perine* v. *William Norton & Co.*, 509 F. 2d 114 (2d Cir. 1974).*

In summary, the legislative history, to the extent that it bears upon this issue, supports the conclusion that Congress intended to include in the proscriptions of § 16(b) all acquisitions of stock which have the effect of carrying the purchaser's ownership above the 10% mark. Accordingly, we respectfully urge that the Ninth Circuit's erroneous view as to Congress' intent not be accepted by this Court.

CONCLUSION

We respectfully submit that this Court should not affirm the judgment below on the grounds expressed by the Ninth Circuit in its opinion.

April 18, 1975

Respectfully submitted,

S. Hazard Gillespie
Counsel for Allis-Chalmers Manufacturing Company
1 Chase Manhattan Plaza
New York, New York 10005
Tel. No. (212) HA 2-3400

---

* Interpretive rules and practices of the agency charged with the administration and enforcement of a statute are accorded authoritative weight. *See, e.g., Bowles* v. *Seminole Rock Co.*, 325 U.S. 410, 414 (1945); *Commissioner* v. *Estate of Sternberger*, 348 U.S. 187, 199 (1955).